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# PRIVATE LIABILITY FOR RECKLESS CONSUMER LENDING

John A. E. Pottow\*

*Congress recently enacted amendments to the Bankruptcy Code that possess the overarching theme of cracking down on debtors due to the increasing rate at which individuals have been filing for bankruptcy. Taking into account the correlation between the overall rise in consumer credit card debt and the rate of individual bankruptcy filings, the author nevertheless hypothesizes that not all credit card debt is troubling. Instead, the author proposes that the catalyst driving individual bankruptcy rates higher than ever is the level of “bad credit”—or credit extended to individuals even though there is a reasonable likelihood that the individual will be forced to default. While the author recognizes the need to hold individuals accountable for the debt they incur, he contends that bankruptcy reform should be targeted towards those creditors who are partly, if not chiefly, responsible for causing a debtor to default, given creditors’ competitive advantage in determining the repayment capacity of individuals. To this end, the author explores the idea of imposing private liability on consumer lenders who bear primary responsibility for a debtor’s financial default through a contract defense to collection, or possibly an affirmative cause of action in tort. Possible consequences of this proposal, such as a reduction in lending activity, are considered and addressed.*

## INTRODUCTION

Congress recently passed what it perceived as long overdue reform to the federal consumer bankruptcy laws.<sup>1</sup> The overarching theme of

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1. Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified as amended in scattered sections of 11 U.S.C.).

these amendments is increased responsibility of debtors to pay back their debts.<sup>2</sup> Congress went tough on debtors,<sup>3</sup> and it is believed this crack-down will stem the burgeoning number of personal bankruptcy filings in this country.<sup>4</sup>

Many scholars have opined that these new laws were ill conceived.<sup>5</sup> One common complaint is that they are overly cumbersome and will drive up the expense of the consumer bankruptcy system enormously for all participants.<sup>6</sup> Compulsory court filings, documentations, calculations, and certifications add much to the cost of a “means test” system for eve-

2. See, e.g., President George W. Bush, Remarks at Signing of Bankruptcy Abuse Prevention Consumer Protection Act (Apr. 20, 2005), available at <http://www.whitehouse.gov/news/releases/2005/04/20050420-5.html> (“[T]oo many people have abused the bankruptcy laws. They’ve walked away from debts even when they had the ability to repay them. . . . Under the new law, Americans who have the ability to pay will be required to pay back at least a portion of their debts.”).

3. See, e.g., Susan Jensen, *A Legislative History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 485 (2005) (chronicling successive legislative proposals to toughen bankruptcy laws against debtors).

4. Annual nonbusiness filings rose from 287,570 in 1980 to 2,039,214 in 2005. See American Bankruptcy Institute, *Annual Business and Non-business Filings by Year (1980–2005)*, available at <http://www.abiworld.org/AM/AMTemplate.cfm?Section=home&Template=/cm/contentdisplay.cfm&contentid=35631>. In the words of an illustrative legislator, “Bankruptcies of convenience are driving this increase [in bankruptcy filings]. Bankruptcy was never meant to be a financial planning tool, but increasingly today, it is becoming a first stop rather than a last resort . . . .” *Bankruptcy Reform and Financial Services Issues: Hearing Before the S. Comm. on Banking*, 106th Cong. 6 (1999) (prepared testimony of Rep. Rick Boucher). In passing the bankruptcy bill, Congress was fixated on the sharp rise in bankruptcy filings. For example, consider the statistical spouting of Rep. George W. Gekas, who was the House Subcommittee on Commercial and Administrative Law’s Chairman:

The bankruptcy crisis is epidemic. A record 1.3 million or more Americans are expected to declare bankruptcy this year, more than double the number of a decade ago, with losses expected to reach \$40 billion. . . .

More than 1.1 million Americans filed for bankruptcy last year, more than triple the number of 1980. Ironically, despite the current economic boom, the bankruptcy rate per household so far in the 1990’s is nearly eight times higher than the rate of the economically depressed 1930’s, and it is climbing every year.

*National Bankruptcy Review Commission Report: Hearing Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary*, 105th Cong. 2 (1997) [hereinafter *NBRC Report Hearing*] (statement of Rep. George W. Gekas, Chairman, Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary).

Ironically, Gekas’ championship of the bankruptcy bill in part proved his undoing, as he was the only incumbent Republican to lose his reelection bid in the 2002 redistricting. Many in Congress, including Gekas, felt that the cause of this “epidemic” was lack of bankruptcy stigma and the general moral decay of debtors. See *id.* The proposal presented in this article—to restrict the supply of abusive consumer credit—will help meet what is contended was Congress’ goal of reducing the explosion of consumer bankruptcy filings. This is so even though it targets a cause of that explosion (the abuse of creditors) different from what many in Congress apparently thought was the cause (the abuse of debtors). See generally John Poirier, *Personal Bankruptcy Cases Rise Despite Reforms*, REUTERS (June 12, 2006) (“‘Some people think that merely reducing the number of filings regardless of who they are and what kinds of problems they have is a success’ . . . .” (quoting Professor Melissa Jacoby)).

5. Letter from Bankruptcy and Commercial Law Professors to Senators Specter and Leahy, (Feb. 16, 2005), available at <http://www.abiworld.org/pdfs/LawProfsLetter.pdf>.

6. Some may see this as a benefit. Cf. James J. White, Professor, University of Michigan Law School, Keynote Address at the University of Missouri Interdisciplinary Perspectives on Bankruptcy Reform Symposium (Feb. 24–25, 2006) (noting cost increases were likely intentional).

ryone—a means test that many concede will catch only a few miscreants.<sup>7</sup> That is a sound critique of the law, but it is widely shared.

The purpose of this article is to take the more pointed position that the reforms were wrongheaded in their entire antidebtor approach in the first place. This stance is not out of sympathy for debtors. It is an objection based on efficiency, fairness, and (to a certain extent) legislative intent. If one accepts Congress' apparent premise that the number of personal bankruptcy filings in the United States is too high,<sup>8</sup> and if one believes, as recent data demonstrate, that consumer bankruptcies vary as a function of personal credit card debt,<sup>9</sup> a better strategy would have been—and would still be—to crack down on *creditors*, not debtors, in order to curtail the number of filings. Instead of, or at least in addition to, targeting debtors, Congress should fix its sights on creditors: paradigmatically, institutional high-rate (subprime) consumer credit card lenders.<sup>10</sup>

Implementing this notion of creditor-focused reform, this article proposes that Congress should consider establishing privately enforceable legal remedies against consumer lenders who bear primary responsibility for a debtor's financial default.<sup>11</sup> "Reckless credit" should become a legally recognized defense to collection on such undesirable loan contracts, and possibly even an affirmative cause of action in tort.<sup>12</sup> The

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7. See Marianne B. Culhane & Michaela M. White, *Taking the New Consumer Bankruptcy Model for a Test Drive: Means-Testing Real Chapter 7 Debtors*, 7 AM. BANKR. INST. L. REV. 27, 54 (1999).

8. See *NBRC Report Hearing*, *supra* note 4 and accompanying text.

9. See, e.g., Lawrence M. Ausubel, *Credit Card Defaults, Credit Card Profits, and Bankruptcy*, 71 AM. BANKR. L.J. 249, 254 (1997).

10. While the correlation between consumer debt generally and bankruptcy might imply the analysis of this article should apply to all forms of consumer debt, the stronger correlation between credit card debt and bankruptcy makes the focus of discussion on credit card lenders appropriate. The case for liability for reckless lending to other forms of low-income-credit lenders is thus somewhat ambiguous. (The correlation is weaker, suggesting the need for policy intervention is less urgent, but it is still present.) Part of the problem with credit cards in particular, as will be discussed, is the dysfunctional business model built on obfuscation. Thus, substitution from credit card lending to, say, pawnbrokers may not necessarily be bad if the latter creditors have at least a more transparent pricing structure.

11. Note at the outset that this article assumes away the constitutional issues in federalizing a contractual defense or a tort cause. See *infra* note 75.

12. Because the discussion in this analysis alternatively considers implementation of the proposal as a partial contract defense, a complete contract defense, or even an affirmative cause of action, an omnibus label is needed to capture these various private law possibilities. "Liability" is chosen to clarify that the lender's targeted activity will invoke legal consequences of at least some remedial degree. "Private" distinguishes the proposal from what Professor Shavell calls "state-initiated" regulatory rules. STEVEN SHAVELL, *ECONOMIC ANALYSIS OF ACCIDENT LAW* 277–86 (1987). (This article simply assumes that the bankruptcy disallowance rule analogue to the contract defense is a "private" remedy, sidestepping the public/private rights distinction that causes constitutional malaise in bankruptcy.) See, e.g., *N. Pipeline Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982) (scrutinizing the constitutionality of 1978 Bankruptcy Reform Act's complex grant of jurisdiction). Note that this terminology of "lender liability" should not be confused by nonbankruptcy readers to refer to the concept of holding lenders liable for the activity of others to whom they loan money (such as, for instance, "lender liability" for borrowers' environmental torts). The liability proposed in this article is for the direct financial activity of the lenders themselves.

proposal does not come on a clean slate. Over thirty years ago, Professor Vern Countryman published a characteristically pithy article arguing for similar relief, and that piece in turn chronicled his efforts that began over forty years ago.<sup>13</sup> Countryman failed to convince Congress; indeed, his proposal was virtually stillborn.<sup>14</sup> I do not flatter myself to be more persuasive than Countryman, nor do I delude myself into thinking that the political environment in this country has become more solicitous toward consumer debtors. The goal is more restrained. This article seeks to explore some of the theoretical foundations as to why such private liability might be a positive and effective intervention given today's new lending environment, and, more importantly, to examine some objections that skeptics are likely to assert.

The article proceeds as follows. Part I explores the problem of reckless lending, and Part II explains the proposal for reckless lending liability. Parts III and IV turn to some of the respective benefits of and problems with the proposal. Part V pauses to consider issues of fairness that surround it. Part VI addresses lingering questions that remain after all these matters have been considered. Part VII concludes.

## I. THE PROBLEM OF RECKLESS CREDIT

Consumer debt has ballooned from approximately \$1.84 trillion to \$2.16 trillion in the past five years alone.<sup>15</sup> Strictly speaking, those numbers prove only that there is "a lot" of consumer credit, not necessarily "too much."<sup>16</sup> The epithet of suboptimality, however, regarding the

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13. See Vern Countryman, *Improvident Credit Extension: A New Legal Concept Aborning?*, 27 ME. L. REV. 1, 17-18 (1975).

14. See David A. Skeel, Jr., *Vern Countryman and the Path of Progressive (and Populist) Bankruptcy Scholarship*, 113 HARV. L. REV. 1075, 1109-10 (2000).

15. See FED. RESERVE BD., STATISTICAL RELEASE, G-19 CONSUMER CREDIT (2006), <http://www.federalreserve.gov/releases/g19/20060307/g19.pdf>.

16. This increase in debt, at least for the subset of borrowers who go bankrupt, has vastly outstripped income. In Countryman's day, a typical bankrupt's debts were \$5000, almost equal to his annual income of \$5200, see Countryman, *supra* note 13, at 1-2. His average debt has now grown to \$63,673 (in 2001 dollars), reflecting 230% of annual income. See Teresa A. Sullivan, Elizabeth Warren & Jay L. Westbrook, *Consumer Bankruptcy Project III* (2001) (unpublished empirical study on file with author). Perhaps as a result, the saving rate in the country has declined from around 9% during the 1970s to around 1% today. See U.S. DEP'T OF COMMERCE, BUREAU OF ECON. ANALYSIS, NATIONAL INCOME AND PRODUCTS ACCOUNT TABLE—SAVINGS AND INVESTMENT (tbl.5.1, <http://www.bea.gov/bea/dn/nipaweb/TableView.asp?SelectedTable=120&FirstYear=2004&LastYear=2006&Freq=Qtr&3Place=Y> (last visited Nov. 15, 2006) (showing that the saving rate has ranged between -1.9% and 2.5% since the first quarter of 2004).

The general population may have had a more stable (but still deteriorating) experience compared to bankrupt debtors. For example, consider the Debt Service Ratio (DSR) and the Financial Obligations Ratio (FOR), two measures of after-tax income available to pay minimum debts (DSR) and minimum debts plus residential leases and other regular payments (FOR). These ratios, compiled by the Federal Reserve Board, show upward trends since 1980, from about 16 to 18% and 10 to 14% respectively. See BD. OF GOVERNORS OF THE FED. RESERVE SYS., REPORT TO THE CONGRESS ON PRACTICES OF THE CONSUMER CREDIT INDUSTRY IN SOLICITING AND EXTENDING CREDIT AND THEIR EFFECTS ON CONSUMER DEBT AND INSOLVENCY 12-13 & fig.3 (2006). One problem with these data, however, is that "minimum payments" for credit cards may result in negative amortization. Another is that they

credit market's current equilibrium becomes justified if one considers both the market conditions in which that debt has been extended and how this level of debt has affected consumer bankruptcy filings.

The first step in understanding the problem of reckless lending is appreciating the link between consumer debt and petitions for bankruptcy. Professor Ronald Mann's recent book reports powerful cross-jurisdictional and time series data showing the correlation between aggregate consumer debt (particularly credit card debt) and bankruptcy filings.<sup>17</sup> (It also shows a correlation between aggregate credit card spending and bankruptcy filings, a fascinating, complex, and worrying trend well beyond the scope of this article.)<sup>18</sup> At one level, that consumer debt correlates with bankruptcy should be an unsurprising discovery. "At first glance, it seems odd to ask whether borrowing causes bankruptcy. Of course it does."<sup>19</sup> But what are especially compelling in Mann's recent data are his time-lag findings regarding (or at least implying) the causative direction of that debt, especially credit card debt. Undermining the contentious claim made by some commentators that generous bankruptcy laws "cause" consumer debtors to load up on debt in anticipation of bankruptcy—due to the *ex ante* incentives set by purportedly lenient discharge rules—Mann offers support for the opposite conclusion: accumulating consumer debt (especially credit card debt) seems to portend bankruptcy, with likelihood increasing as time goes by.<sup>20</sup> Thus, Mann's data, enriched by comparisons across countries, underscore the finding that was only intuitive in Countryman's day. Increased consumer debt, specifically credit card debt, may in large part fuel the bankruptcy boom.<sup>21</sup>

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are aggregate data and hence do not show heterogeneity; case study data suggest bankrupt debtors bear a disproportionately heavy debt service burden.

17. See RONALD J. MANN, *CHARGING AHEAD: THE GROWTH AND REGULATION OF PAYMENT CARD MARKETS AROUND THE WORLD* 80–81 tbls.5.1 & 5.2 (2006) [hereinafter MANN, *CHARGING AHEAD*]. Mann's use of aggregate, country-level data (as opposed to family- or even individual-level data) is discussed in a thoughtful methodological analysis in a subsequent paper. See Ronald J. Mann, *Cards, Consumer Credit & Bankruptcy* 8 (Univ. of Tex. Sch. of Law, Law & Econ. Research Paper No. 44, 2006) [hereinafter Mann, *Cards, Consumer Credit & Bankruptcy*], available at <http://ssrn.com/abstract=690701>.

18. MANN, *CHARGING AHEAD*, *supra* note 17, at 81 tbls.5.3 & 5.4 (finding "gratifying" *R*-squared of .94 after introduction of macroeconomic variables).

19. *Id.* at 194 (explaining the special role of credit card debt, which seems to correlate strongly with bankruptcy filings even when overall consumer debt is held constant).

20. *Id.* Actually, Mann reports finding a time effect that peaks and then tapers off, with the peak occurring between one and two years. See *id.* at 70–71 tbls.5.1 & 5.2. Mann considers the time horizon implicated by these findings implausible to reconcile with strategic debtor planning. For recent data consistent with Mann's skepticism of *ex ante* incentive sensitivity, see *infra* note 152. The *ex ante* effect of reverse causality that Mann challenges was explored by F. H. Buckley and Margaret F. Brinig in *The Bankruptcy Puzzle*, 27 J. LEGAL STUD. 187 (1998). For a helpful literature review on empirical studies looking at the causes of bankruptcy filing rates, see Robert M. Lawless, *The Paradox of Consumer Credit*, 2007 U. ILL. L. REV. 347.

21. The link between consumer debt and bankruptcy is a complex one whose full exploration lies beyond the scope of this discussion. Professor Robert Lawless explores the interaction between debt and bankruptcy filings, discovering a curious short-term effect where increased consumer debt might

The next step in understanding the problem of reckless credit is making the point that is intuitive to some, and perhaps many, that bankruptcy is generally bad. Clearly, Congress was concerned with the rising number of bankruptcy filings,<sup>22</sup> as were other policymakers around the world.<sup>23</sup> Noting the unwelcomeness of bankruptcy, therefore, may be an exercise in overdetermination.<sup>24</sup> Nevertheless, it does warrant explicit

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actually *decrease* the likelihood of bankruptcy, which Lawless attributes to debtors loading up on credit in an unsuccessful attempt to stave off default. See Lawless, *supra* note 20. This strategy perhaps delays bankruptcy (hence the short-term decrease in filing), but may prove ultimately unsustainable, thus explaining a longer-term rise of the order found by Mann. Moving the discussion of the link between debt and bankruptcy to a new level of empirical analysis, Lawless astutely comments: "Observing that debt is a precondition to bankruptcy, however, does not tell us anything about how much debt causes how much bankruptcy. Stated alternatively, that observation tells us nothing about the shape of the curve—if it is a curve—that describes the relationship between bankruptcy filings and consumer debt." *Id.* at 348.

The Federal Reserve Board's report to Congress required by BAPCPA ultimately concludes that the causes of bankruptcy are "related to a number of factors, including an increase in revolving consumer credit use," although it doubts that the credit card industry's business practices can bear all the blame. BD. OF GOVERNORS OF THE FED. RESERVE SYS., *supra* note 16, at 18. One particularly highly correlated variable to bankruptcy discussed in this report is the unemployment rate. See *id.*

22. The characterization of BAPCPA as fighting not just the escalating incidence of bankruptcy filings but also the correlated level of aggregate consumer credit card debt imputes to Congress a rational agenda of trying to confront two causally related phenomena. This may not be descriptively accurate, especially for hardened public choice analysts. Indeed, while it is likely that the creditor-dominated lobbying interests who shaped BAPCPA wanted to diminish bankruptcy filings when designing the new bill, it is most unlikely that they wanted Congress to take the logically related step of restricting the issuance of highly profitable consumer credit card debt. For purposes of conceptual purity, the policy prescriptions of this article attribute to Congress altruistic motives in combating a perceived social problem. An insightful new analysis of the creditor lobbying interests (and alignment and disalignment of subconstituencies therein) can be found in William C. Whitford, *A History of the Automobile Lender Provisions of BAPCPA*, 2007 U. ILL. L. REV. 143.

23. Many countries have proceeded with regulatory action on the assumption that there is a widespread problem of excessive consumer indebtedness and a concomitant increase in personal insolvencies. See, e.g., THE GRIFFITHS COMM'N ON PERSONAL DEBT, WHAT PRICE CREDIT? (2005) [hereinafter GRIFFITHS COMM'N], available at <http://www.niace.org.uk/news/Docs/Griffiths-report-on-personal-debt.pdf>. In addition to the Griffiths Commission Report, the U.K.'s Department of Trade & Industry (DTI) has issued a series of its own reports, which contain reviews of research related to overindebtedness, legislative proposals for action, and follow-up progress updates on implementation efforts. See, e.g., DEP'T OF TRADE & INDUS., TACKLING OVER-INDEBTEDNESS: ANNUAL REPORT 2006 (2006) [hereinafter DEP'T OF TRADE & INDUS., TACKLING OVER-INDEBTEDNESS 2006], available at <http://www.dti.gov.uk/files/file33134.pdf>; DEP'T OF TRADE & INDUS., OVER-INDEBTEDNESS IN BRITAIN: A DTI REPORT ON THE MORI FINANCIAL SERVICES SURVEY 2004 (2005) [hereinafter DEP'T OF TRADE & INDUS., OVER-INDEBTEDNESS IN BRITAIN], available at <http://www.dti.gov.uk/files/file18550.pdf>; DEP'T OF TRADE & INDUS., FAIR, CLEAR, AND COMPETITIVE: THE CONSUMER CREDIT MARKET IN THE 21<sup>ST</sup> CENTURY (2003) [hereinafter DEP'T OF TRADE & INDUS., FAIR, CLEAR, AND COMPETITIVE], available at <http://www.dti.gov.uk/files/file23663.pdf>; see also UDO REIFNER ET AL., CONSUMER OVERINDEBTEDNESS AND CONSUMER LAW IN THE EUROPEAN UNION 15 (2003). Indeed, the Europeans not only view bankruptcy as unwelcome, but as a late-stage response to a broader problem of consumer "overindebtedness," a problem that should be ideally targeted with preventative, earlier stage measures. See REIFNER ET AL., *supra*; see also DEP'T OF TRADE & INDUS., TACKLING OVER-INDEBTEDNESS: ACTION PLAN 2004 (2004) [hereinafter DEP'T OF TRADE & INDUS., TACKLING OVER-INDEBTEDNESS 2004], available at <http://www.dti.gov.uk/files/file18559.pdf>.

24. That bankruptcy is generally bad does not necessarily mean we should strive to vanquish it. A variety of financial contingencies make life uncertain, and sometimes bankruptcy is a necessary consequence of a risk-filled world. "Many life decisions . . . are ones that most of us make only once. We are not afforded the opportunity for rehearsals, and for the most part we do not have do-overs." Douglas Baird, *Technology, Information, and Bankruptcy*, 2007 U. ILL. L. REV. 305, 318. Addition-

mention that empirical studies into the lives of the bankrupt reveal serious personal and financial suffering.<sup>25</sup> Few relish financial default.

A related but distinct point about the undesirability of consumer bankruptcy pertains to whether and to what extent a bankruptcy filing imposes negative externalities.<sup>26</sup> Few scholars today maintain that personal bankruptcy is a fully isolated, internalized occurrence between a debtor and creditor alone.<sup>27</sup> When a debtor files for consumer bankruptcy, it is not just the debtor and his hypothetically cost-adjusting creditors who suffer. As summarized by one prominent government report, there is a “knock-on effect” to a filing.<sup>28</sup> Nonadjusting creditors (that is, creditors who cannot adjust their credit prices to account for default risk)<sup>29</sup> also get hurt when a debtor declares bankruptcy, because the Bankruptcy Code accelerates and liquidates *all* debts (at discount), even those not in default. The debtor’s family and others in her circle of intimates suffer too, experiencing the very tangible psychological and monetizable costs when a debtor endures general default. Assuming one subscribes to a relatively nuanced view of intrahousehold dynamics (as some feminist scholars have critiqued the original Beckerian view for failing to

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ally, the bankruptcy discharge is now understood to foster socially beneficial risk-taking by ensuring small business debtors who use the consumer system a “soft landing” of generous personal discharge to encourage their economically stimulating behavior. See, e.g., Rafael Efrat, *Global Trends in Personal Bankruptcy*, 76 AM. BANKR. L.J. 81 (2002) (comparing different national bankruptcy regimes and entrepreneurial activity). Thus, some bankruptcy may be “good” (or at least “tolerable”). Indeed, Baird notes that borrowing for durable assets such as homes is perhaps not as troubling as borrowing to finance current consumption. And even borrowing for current consumption itself may not be inherently bad if it reflects rational life cycle consumption smoothing. See Baird, *supra* note 24, at 309. “Appropriately” animated loans (e.g., consumption smoothing and home buying) therefore should not trouble us, even if some of these loans do lead to bankruptcy for the borrower as a result of unforeseen circumstances, innocent miscalculation, or just bad luck. What should trouble us, however, are the kinds of loans explored in this article: those that, at the time of their origination, are known to be unserviceable and hence sowing the seeds for an inevitable trip through bankruptcy.

25. See generally TERESA A. SULLIVAN ET AL., *THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT* 75–237 (2000); see also GRIFFITHS COMM’N, *supra* note 23, at 3 (noting that “all MP’s have had to deal with constituency cases in which the personal suffering resulting from excessive debt has been all too apparent”).

26. Note that the whole bankruptcy system itself can be seen as susceptible to a “first-party insurance externality,” Jon D. Hanson & Kyle D. Logue, *The First-Party Insurance Externality: An Economic Justification for Enterprise Liability*, 76 CORNELL L. REV. 129 (1990), to financial distress, because many scholars view the consumer bankruptcy system as a social insurance fund for financial catastrophe, and the system does not, by design, charge premiums. See, e.g., Barry Adler et al., *Regulating Consumer Bankruptcy: A Theoretical Inquiry*, 29 J. LEGAL STUD. 585 (2000).

27. See generally MANN, *CHARGING AHEAD*, *supra* note 17, at 196 (noting that “consumer credit markets generate substantial externalities, at least when they lead to financial default” and offering illustrative citations). In one of the more important theoretical attempts to explore the insurance function of consumer bankruptcy, see Adler et al., *supra* note 26, at 591, the authors disavow externality considerations, but that is a concession made apparently for convenience.

28. GRIFFITHS COMM’N, *supra* note 23, at ii (noting such effect “is a cost both to society and the public purse”).

29. See Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857, 863–64 (1996). Professor Guzman later divided this constituency into “strongly” and “weakly” nonadjusting creditors. See Andrew T. Guzman, *International Bankruptcy: In Defense of Universalism*, 98 MICH. L. REV. 2177, 2182 (2000).



do),<sup>30</sup> then these nondebtor, intrahousehold costs would be recorded in the externality ledger as well.<sup>31</sup> Finally, society as a whole also loses when moping bankrupt debtors are distracted from working at their highest and best-use level of productivity because they are instead coping with financial ruin.<sup>32</sup>

To be sure, the case for negative bankruptcy externalities is more intuitive than empirical at this juncture. Indeed, consider, by way of contrast, the enormous intellectual energy that has been spent trying to quantify the externality costs of smoking tobacco.<sup>33</sup> Nothing of the sort has been undertaken in the bankruptcy realm to date. Appropriate inferential caution therefore should be exercised. Yet the data we do have, especially the case studies of Teresa Sullivan, Elizabeth Warren, and Jay Westbrook, support the intuition of far-reaching negative consequences to a consumer's fall into bankruptcy.<sup>34</sup>

The final step in understanding the problem of reckless credit requires appreciating two important elements of the current consumer credit card market. The first involves the traits of the borrower. Con-

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30. For the original conception of the household economic unit with its altruistic head, see GARY S. BECKER, *A TREATISE ON THE FAMILY* (1991). For a feminist critique of this model, see Frances R. Woolley & Judith Marshall, *Measuring Inequality Within the Household*, 40 REV. INCOME & WEALTH 415 (1994).

31. This interpretation of intrahousehold externalities is embraced by some torts scholars. See Jon D. Hanson & Kyle D. Logue, *The Costs of Cigarettes: The Economic Case for Ex Post Incentive-Based Regulation*, 107 YALE L.J. 1163, 1238–40 (1998). Professors Hanson and Logue also point out the interaction between cognitive bias (such as optimism and myopia) and predicting the disutility that smoking imposes on family members. Because the same cognitive shortcomings help drive the reckless lending problem, there is comparable reason to treat the debtor's accounting of the costs on his household with similar skepticism.

32. See generally GRIFFITHS COMM'N, *supra* note 23, at 3 (noting that "all MP's have had to deal with constituency cases in which the personal suffering resulting from excessive debt has been all too apparent"); SULLIVAN ET AL., *supra* note 25, at 75–237. These externality concerns do not even get into the noneconomic considerations of fairness and dignity inexorably involved in the function of a bankruptcy system. See, e.g., Charles Jordan Tabb, *The Scope of the Fresh Start in Bankruptcy: Collateral Conversions and the Dischargeability Debate*, 59 GEO. WASH. L. REV. 56, 89–103 (1990) (explaining various theories behind the discharge of consumer debt). Such an approach also does not view the Schellingian idea of multiple selves as creating an externality problem (from the present self to the future self). See THOMAS C. SCHELLING, *CHOICE AND CONSEQUENCE* (1984) (discussing the notion of multiple selves); see also Hanson & Logue, *supra* note 31, at 1241 (arguing that multiple selves do create an externality problem).

33. For example, Professors Hanson and Logue published a book in the *Yale Law Journal* in part to claim that Professor Kip Viscusi's calculations of the costs of cigarette smoking likely understated the externalities by approximately \$7 per pack. See Hanson & Logue, *supra* note 31, 1354–61 (critiquing W. KIP VISCUSI, *SMOKING: MAKING THE RISKY DECISION* (1991) and WILLARD G. MANNING ET AL., *THE COSTS OF POOR HEALTH HABITS* (1991)). The sophistication of Hanson and Logue's analysis (and that of the studies they critique) demonstrates that their field is light years ahead of bankruptcy scholarship with respect to the depth of its empirical research into the scope and costs of externalities in one product market. See also *id.* at 1177–78 ("[C]igarettes present an especially attractive subject of study because of an abundance of relevant empirical data.").

34. The proposal of this article for legal liability for reckless lending does not depend on the presence of negative externalities from bankruptcy. Obviously, the case for legal intervention is strengthened by the degree to which externalities pervade, but it does not require them.

sumers of unsecured revolving credit are notoriously irrational.<sup>35</sup> As others in the past have taught us,<sup>36</sup> and as new studies continue to show,<sup>37</sup> consumers fall victim to commonplace departures from rationality.<sup>38</sup> The principal concern with credit borrowing is with the cognitive bias for risk underestimation and the irrational discounting (myopia) that makes “seduction by plastic” so attractive.<sup>39</sup> This is an acute problem in credit card borrowing, because the repayment terms for typical debt products usually stretch out for years if not decades.<sup>40</sup> Compounding this problem is the pricing structure of credit cards. With constantly changing terms within an overarching tripartite framework, credit cards are difficult if not impossible for even a diligent consumer to price.<sup>41</sup> Accordingly, one

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35. To be sure, however, there is a subset of consumers who certainly are able to “game the system,” as recognized by the DTI Reports in the United Kingdom. See, e.g., ELAINE KEMPSON, DEP’T OF TRADE & INDUS., OVER-INDEBTEDNESS IN BRITAIN: A REPORT TO THE DEPARTMENT OF TRADE AND INDUSTRY 44–49 (2002) (focusing on “irresponsible borrowing” as separate phenomenon from “irresponsible lending”). Even Kempson’s discussion, however, lops “impulsive” borrowers in with “deliberate” overborrowers in the “irresponsible” category. Strict system-gamers would include only deliberate overborrowers.

36. The literature on the myriad cognitive imperfections of consumers is nothing short of voluminous. For an excellent summary, see Christine Jolls, Cass Sunstein, & Richard Thaler, *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998). The phenomena of particular application to consumer borrowers are what Jolls, Sunstein, and Thaler call overoptimism, see, e.g., Neil D. Weinstein, *Unrealistic Optimism About Future Life Events*, 39 J. PERSONALITY & SOC. PSYCH. 806 (1980); inability to experience preference utility, see, e.g., Daniel Kahneman, *New Challenges to the Rationality Assumption*, in THE RATIONAL FOUNDATIONS OF ECONOMIC BEHAVIOUR 203 (Kenneth J. Arrow et al. eds., 1996); and hyperbolic discounting, see, e.g., David Laibson, *Golden Eggs and Hyperbolic Discounting*, 112 Q.J. ECON. 443 (1997). Professor Oren Bar-Gill provides a helpful graphical model of hyperbolic discounting in his analysis of the credit card market. See Oren Bar-Gill, *Seduction by Plastic*, 98 NW. U. L. REV. 1373, 1396–99 (2004).

37. See Victor Stango & Jonathan Zinman, *How Cognitive Bias Shapes Competition: Evidence from the Consumer Credit Markets* 4–7 (Working Paper, 2006), available at <http://ssrn.com/abstract=928956> (finding “payment interest bias” in analysis of 1983 Survey of Consumer Finances panel data of systemic undercalculation of APRs, a bias which varies by identity of lender). For evidence of further underestimation of risk regarding mortgage rate variability under adjustable rate products, see Brian Bucks & Karen Pence, *Do Homeowners Know Their House Values and Mortgage Terms?* 2 (Fed. Reserve Bd. of Governors Fin. & Econ. Discussion Series, 2006), available at <http://ssrn.com/abstract=899152>.

38. See Bar-Gill, *supra* note 36, at 1373. For some time, bankruptcy commentators have been skeptical of the cognitive capacity of consumer debtors. See, e.g., Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1408 (1985). For a detailed discussion of the “psychological barriers” faced by consumer borrowers, see REIFNER ET AL., *supra* note 23, at 108. For an indirect critique, see Alan Schwartz, *Unconscionability and Imperfect Information: A Research Agenda*, 19 CAN. BUS. L.J. 437, 448–49 (1991) (questioning the applicability of availability heuristic to consumer bankrupts and application of underestimation bias given debtor heterogeneity).

39. Bar-Gill, *supra* note 36, at 1395.

40. See, e.g., Coalition for Debtor Education, Minimum Payments, <http://www.nyls.edu/pages/1459.asp> (last visited Nov. 15, 2006) (“If only minimum payments are made, it can take years, and sometimes decades, to achieve full repayments.”).

41. See Mann, *Cards, Consumer Credit & Bankruptcy*, *supra* note 17, at 11. The GAO’s report *Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers* commissioned a “readability” and “usability” consultant to investigate commonly used credit card contracts and found serious problems. For example, the complexity of the language was above the median national literacy rate, half the subjects interviewed could not identify the purportedly “disclosed” default interest rate, half did not realize penalties could be applied, and over two-thirds were unsure or did not think their rates could change. See GOV’T ACCOUNTABILITY OFFICE, CREDIT CARDS: INCREASED COMPLEXITY IN RATES AND FEES HEIGHTENS NEED FOR MORE

of the problems of credit cards that may be driving bankruptcy is that debtors simply cannot appreciate what they often get themselves into: unserviceable levels of debt.<sup>42</sup>

The second troubling attribute of the consumer debt market is the incentive issuers have to lend money to borrowers who may end up defaulting on their loans, which turns the conventional paradigm of credit risk assessment on its head. Traditionally, banks extending long-term credit, such as a home purchase mortgage, would scrutinize debtors carefully to minimize the chance of default and write-off in a relatively competitive and low-margin business.<sup>43</sup> By contrast, the current business model of some consumer lenders for revolving credit card debt presents an apparent paradox. Instead of adhering to the conventional perspective of minimizing risk and avoiding default, lenders are extending credit to debtors who very likely *cannot* repay (i.e., they are making “reckless” loans).<sup>44</sup>

The first-blush absurdity of lenders making likely-to-be charged-off loans in a competitive market dissolves, however, when one recognizes that it is not necessarily a money-losing proposition to have a portfolio of possibly or even likely defaulting debtors. In a candid analysis of the consumer credit industry, Professor Lawrence Ausubel explains why the current business model and fee structure of many lenders may well make it profitable to lend to seemingly bad borrowers if the amount captured in fees in servicing those accounts exceeds the cost of written-off princi-

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EFFECTIVE DISCLOSURES TO CONSUMERS 49–50 (2006), available at <http://www.gao.gov/new.items/d06929.pdf>.

42. It is perhaps for this reason that negative amortization minimum payment rules are seen as an example of (privately actionable) extortionate credit in the Griffiths Commission Report’s commentary on the new U.K. Consumer Credit Bill. See GRIFFITHS COMM’N, *supra* note 23, at apps. 2.5 & 2.6.

43. This rule of thumb is even being eroded in the mortgage market, with home equity products permitting increasing amounts of leverage, especially in the burgeoning subprime mortgage market. See, e.g., Sue Kirchhoff & Sandra Block, *Subprime Loan Market Grows Despite Troubles*, USA TODAY, Dec. 7, 2004, at 1B (“Subprime lending . . . has been the fastest-growing part of the mortgage industry.”). Still, mortgage charge-off rates remain less than 1%, well below credit card rates. See GOV’T ACCOUNTABILITY OFFICE, *supra* note 41, at 99.

44. Strictly speaking, the debtors can, and do, “pay back” their loans in the economic sense that the accumulated fees constitute a profitable return to the lenders before ultimate default. The problem is that the nominal terms of the loan compel the debtor to pay ongoing interest charges and fees, which continue to climb. Were these terms transparently priced, many debtors might decline entering into their contracts, just as if they were perfectly informed, they would realize that the current form terms can lead to default. See, e.g., *Discover Bank v. Owens*, 822 N.E.2d 869, 874–75 (Ohio Mun. Ct. 2004) (chastising creditor—and allowing defense to collection suit—for unconscionable practice of mounting interest charges for obviously insolvent client).

Note that recent regulation efforts of “predatory” subprime mortgage lenders recognize that these lenders often have insufficient incentive to gauge borrower ability to pay under current practices. As a result, many of these efforts trigger liability when lenders seek to lend to borrowers above a certain debt-income ratio (usually 50% of gross monthly income). See Giang Ho & Anthony Pennington-Cross, *The Impact of Local Predatory Lending Laws* app. A (Fed. Reserve Bank of St. Louis, Working Paper No. 2005-049B, 2005), available at <http://research.stlouisfed.org/wp/2005/2005-049.pdf>.

pal (and the opportunity and service costs of capital) for failed debt.<sup>45</sup> As summarized by one prominent skeptic, “[consumer lenders] make millions of bad loans each year [for] the simple reason that it is more profitable to lend to virtually everyone and let bankruptcy sort them out than it is to identify in advance those unlikely to pay and refuse to lend to them.”<sup>46</sup> As reported more explicitly in the United Kingdom: “In the words of the credit risk department head of a leading lender, ‘The accounts that are headed for delinquency will look like your most profitable.’”<sup>47</sup>

Most fortuitously, Professor Mann has just modeled this unusual business practice.<sup>48</sup> Mann makes some conservative assumptions regard-

45. Ausubel, *supra* note 9, at 263 (building on and summarizing earlier work). More precisely, Ausubel points out that the correlation between high default rates and credit card issuer profitability likely means that as issuers become increasingly profitable, they tolerate increasing default. *Id.* at 264. This phenomenon was even recognized by the bankruptcy courts in the United States. See *Sears, Roebuck & Co. v. Hernandez (In re Hernandez)*, 208 B.R. 872, 879 (Bankr. W.D. Tex. 1997) (“Credit issuers are willing to risk nonpayment because the profits on finance charges exceed their risks.”), quoted in David F. Snow, *The Dischargeability of Credit Card Debt: New Developments and the Need for a New Direction*, 72 AM. BANKR. L.J. 63, 81 (1998).

46. Lynn M. LoPucki, *Reforming Consumer Bankruptcy Law: Four Proposals*, 71 AM. BANKR. L.J. 461, 466 (1997) (citing Ausubel, *supra* note 9).

47. KEMPSON, *supra* note 35, at 39 (citing Murray Bailey, *Do US Credit Limit Management Strategies Apply Outside the US?*, CREDIT RISK MANAGEMENT, May–June 2002, at 39–41).

One U.S. senator highly suspicious of credit card business practices inserted section 1229 into BAPCPA, which reported the sense of the Congress that—

(1) certain lenders may sometimes offer credit to consumers indiscriminately, without taking steps to ensure that consumers are capable of repaying the resulting debt, and in a manner which may encourage certain consumers to accumulate additional debt; and

(2) resulting consumer debt may be a major contributing factor to consumer insolvency.

BAPCPA, Pub. L. No. 109-8, § 1229(a)(1)–(2), 119 Stat. 23, 200. Section 1229 required the Federal Reserve Board to prepare a report to Congress within twelve months on “consumer credit industry practices of soliciting and extending credit.” *Id.* § 1229(b)(1). The Board complied. Its report, however, is somewhat of an anticlimax. About twenty-five pages long, it quickly reviews some economic research and ultimately concludes that while credit card debt is correlated with consumer insolvency, lenders likely do not solicit borrowers who cannot repay. See BD. OF GOVERNORS OF THE FED. RESERVE SYS., *supra* note 16, at 2–3. Its conclusion for the latter point stems, essentially, from only two observations: first, that the consumer credit industry is heavily regulated, and second, that lenders use credit scores in prescreening customers. See *id.* at 19–20. That some lenders might be using the scores to preselect risky customers seems to have escaped the report’s authors. Indeed, as an example of the cursory nature of the report, one source of evidence it cites to show that lenders do not solicit high-risk borrowers is “market discipline.” *Id.* at 2. In fairness to the report’s authors, part of the problem was the broad and inflated language of the congressional mandate to examine “indiscriminate” practices.

A much richer, more nuanced study, complete with original research, was released just as this article was going to press—the GAO’s 108-page report on credit cards. See GOV’T ACCOUNTABILITY OFFICE, *supra* note 41. While the GAO report does not analyze subprime lender practices, it does look at the role penalty fees and interest play in affecting a small but increasing minority of borrowers. It reports, for example, that one-third of credit card customers have paid some form of penalty and that the proportion of borrowers paying more than 25% interest—a proxy for default penalty interest—has doubled from 5% in 2003 to 11% in 2005. See *id.* at 70. This report also finds lenders are “increasingly emphasizing competitive strategies that seek to increase the amount of spending that existing cardholders do on their cards.” *Id.* at 22.

48. Ronald J. Mann, *Bankruptcy Reform and the “Sweat Box” of Credit Card Debt*, 2007 U. ILL. L. REV. 375.

ing outstanding borrowing balance, interest terms (regular and penalty), late payment fees, repayment minimums, and cost of funds to issuers. The model is not perfect,<sup>49</sup> but its general conclusions are likely sound.<sup>50</sup> He finds that if certain consumers can be kept servicing their minimum payments for a breakeven period that may be as brief as two years, an issuer can profit even on loans that wind up being written off entirely; every payment beyond that breakeven point is gravy.<sup>51</sup> Whether the debtor then falls into bankruptcy—with its attendant negative fallout on himself and possibly others—becomes at best an ancillary concern for the issuer. Relaxing the assumption that every loan fails (46% of borrowers carry a balance on their credit cards and the charge-off rate is nowhere close to 46% of loans),<sup>52</sup> the profitability of the high-margin consumer credit industry becomes apparent. Mann's term for the business model of squeezing a few years of fees out of debtors before financial default, coined by Professor Jay Westbrook, is the "sweatbox."<sup>53</sup> Even if the lender knows that his loan is highly likely to bankrupt the debtor and be written off in whole or in part, he does not care because he makes back his investment in penalty interest and fees relatively quickly regardless of the remaining principal balance. Once this point passes, he is content to let the chips of his improvident loan fall where they may, indifferent to the harm on the debtor and the potential externalities imposed on others.<sup>54</sup>

Indeed, these two attributes of the consumer lending market interact, as one of the ways lenders lure debtors into their sweatbox is by preying upon their underestimation and optimism biases.<sup>55</sup> "Shrouding"

49. For example, it omits advertising, issuing, administration, and collection costs. These may delay the lender's breakeven point. For similar modeling that is even more detailed, see DEP'T OF TRADE & INDUS., *THE EFFECT OF INTEREST RATE CONTROLS IN OTHER COUNTRIES* 30–32 (2004).

50. One of the interesting questions is how and why this business model developed. I suspect it required a critical mass of credit card proliferation as a lending product, coupled with the deregulation through the effective abolition of usury, *Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978), as necessary preconditions.

51. Mann, *Cards, Consumer Credit & Bankruptcy*, *supra* note 17, at 15.

52. *Id.* at 10 n.53. Credit card lenders have charge-off rates of around 5%. See GOV'T ACCOUNTABILITY OFFICE, *supra* note 41, at 99.

53. *Id.* There are of course further problems with the consumer credit lending market, such as, for example, express discrimination by lenders, see URBAN INST., DEP'T HOUS. & URBAN DEV., *WHAT WE KNOW ABOUT MORTGAGE LENDING DISCRIMINATION IN AMERICA* (1999) ("Minorities are less likely than whites to obtain mortgage financing and, if successful in obtaining a mortgage, tend to receive less generous loan amounts and terms."), and other problems of general wretchedness. See generally DAVID CAPLOVITZ, *THE POOR PAY MORE: CONSUMER PRACTICES OF LOW-INCOME FAMILIES* (1967).

54. See REIFNER ET AL., *supra* note 23, at 44–45 ("[T]hrough aggressive marketing and sophisticated solicitation techniques, [these lenders] reach less and less creditorworthy debtors and higher charge-off rates. These charge-off rates are just part of the business of the lender and are taken into account in the conditions under which credit is made available [i.e., pricing]. For the consumer debtor who cannot repay his debts, it may result in personal tragedy.").

55. See KEMPSON, *supra* note 35, at 40–44, on "irresponsible lending" habits that do so. *Over-indebtedness in Britain: A DTI Report on the MORI Financial Services Survey 2004* presents intriguing empirical data on how few self-reported financially burdened individuals recognize their objective financial peril. See DEP'T OF TRADE & INDUS., *OVER-INDEBTEDNESS IN BRITAIN*, *supra* note 23.

the terms of their contracts through moving price terms, the lenders attract borrowers—"manipulating" them, in the assessment of some psycho-economic observers<sup>56</sup>—who likely cannot repay their debts and hence will be the most likely to sweat. The sweatbox is actually a two-stage model that entices all borrowers at the outset with low rates, but then cranks up the heat through late payment fees and penalty rates for the "sweaters."<sup>57</sup> Thus, perversely, lenders are not just indifferent to default, they actually rely in part upon it to turn on the sweatbox's heat switch for their most lucrative constituency.<sup>58</sup>

Fitting all these pieces together reveals a serious problem. It is not simply an issue of excessive credit, although, to be sure, the sheer magnitude of consumer debt is troubling in its own right, and the correlation with bankruptcy has been documented. It is a problem of *reckless* credit. The sweatbox model of credit card lending is built on not only accepting, but affirmatively soliciting borrowers who will likely have a hard time repaying their debt.<sup>59</sup> To deploy this model, lenders exploit the cognitive

56. Ron Harris & Einat Albin, *Bankruptcy Policy in Light of Manipulation in Credit Advertising*, 7 THEORETICAL INQUIRIES L. 431, 443–47 (2006). The authors recount a Bank Leumi advertisement in Israel that has an older self talking, from the future, to a younger self about the benefits of borrowing:

Younger Self: "How can I afford this?"

Elder Self: "Believe me, in the future you'll have enough money, now be spontaneous and just do it."

*Id.* at 432. The term "shrouding" is used by Xavier Gabaix & David Laibson, *Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets* (MIT Dep't of Econ., Working Paper No. 05-18, 2005), available at <http://ssrn.com/abstract=728545>. There are also, however, data suggesting that certain low-income borrowers have seemingly inelastic demand for credit. A good discussion of these data appears in DEP'T OF TRADE & INDUS., *supra* note 49, at 10–16 (looking at demand effects across jurisdictions regarding credit price caps).

57. Thus, the current model actually permits the same credit product to be issued to two tiers of consumers: convenience users who use it as a charge card and "sweaters" who build up a debt level. The sweaters perhaps make minimum payments during the escalation period, and then trip a wire (e.g., by setting off a late payment or universal default clause) that triggers the high rates and fees of the sweatbox. See *Marketplace* (National Public Radio broadcast Apr. 19, 2006) (interview with bankrupt debtor who was able to take out \$40,000 on credit cards while looking for work, service his minimum payments, but ultimately missed a payment, which triggered a 30% interest rate and ultimate bankruptcy). Note in this regard that it is not the subprime lending market in general that is troublesome, but the sweatbox model of certain credit card lenders. For example, the U.K.'s Department of Trade and Industry actually seems to be defending "doorstop lending" from its conventional attacks as an important credit provider to low-income households and even treats with cautious optimism the arrival of payday lenders. See DEP'T OF TRADE & INDUS., *supra* note 49, at 39–40.

58. The sweatbox model would run into trouble if default led to instantaneous bankruptcy. For this reason, Mann opines (and I agree) that what credit card lenders wanted in the new bankruptcy bill was not necessarily to force debtors into chapter 13 through a bright-line and quickly administrable gate-keeping rule, but rather to make it harder, more expensive, and more cumbersome to get into bankruptcy in the first place and thus to require debtors to spend more time sweating, once the writing is on the wall, before receiving bankruptcy relief. It also probably goes without saying that in settlement-driven legal regimes, such as bankruptcy, improving one's legal endowment is always a lobbying goal. See Mann, *supra* note 48. Note that the reliance of credit card lenders on "sweaters" is underscored by their recent worries regarding an uptick in repayment rates for the first quarter of 2006. See Robin Sidel, *Credit-Card Issuers' Problem: People are Paying Their Bills*, WALL ST. J., May 25, 2006, at A1.

59. See Robert Berner, *Cap One's Credit Trap*, BUSINESSWEEK, Nov. 6, 2006 (reporting practice of responding to distressed consumers penalized with overlimit fees by offering further low-limit credit cards), available at [http://www.businessweek.com/magazine/content/06\\_45/b4008048.htm](http://www.businessweek.com/magazine/content/06_45/b4008048.htm).

and other frailties of consumers in a manner that is impervious to the (likely externalized) costs of default.<sup>60</sup> Indeed, the problem of reckless credit is not so much one of reckless *borrowing* but more one of reckless *lending*.<sup>61</sup> The bankruptcy-causing debt is incurred by an unwitting clientele of confused and manipulated borrowers and the costs of the debt are not fully born by its profiteers.

Accordingly, it is not all credit, but “bad” credit that is the source of concern. Openly declaring war on all credit cards—such as outlawing them entirely—would therefore widely overshoot the mark.<sup>62</sup> A policy prescription needs to be focused on “bad” credit specifically. For example, hoping to isolate these “bad” elements of credit card debt, Professor Mann strives for a perfectly transparent and priceable credit product that will allow consumers to make informed choices about their credit levels and thus only use “good,” economy-growing credit.<sup>63</sup> His aspirations are of course sound policy. But if one were more pessimistic than Mann about the prospects of disclosure-based regimes, then one might be will-

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60. Bar-Gill, *supra* note 36, at 1376.

61. KEMPSON, *supra* note 35, at 8, recognizes that there are factors of both irresponsible borrowing and lending at work, although the thrust of the reform initiatives in the United Kingdom and the European Union are focused on the problems of irresponsible lending, which suggests the lion's share of the problems lie with the lenders. For example, REIFNER ET AL., *supra* note 23, at 100–01, examine different national approaches, including German concern with *sittenwidrige Überschuldung* (immoral overburdening with debts) and Swedish regulation under its Consumer Credit Act and Banking Act, which expressly proscribe extending credit to those who cannot be expected to pay and allow a private remedy of debt adjustment as relief. Their report also recognizes the danger of overregulation and approvingly quotes Article 9 of the first draft of the E.U. Consumer Credit Directive (“Responsible Lending”), but cautions that if the principle of responsible lending is overapplied, it could backfire and drive excluded borrowers to less savory lending markets. See *Proposal for a Directive of the European Parliament and of the Council on the Harmonization of Laws, Regulations, and Administrative Provisions of Member States Concerning Credit for Consumers*, at 7, 15–16, 40, COM (2002) 443 final (Sept. 11, 2002) [hereinafter *Consumer Credit Directive*], available at [http://www.ecri.be/media/documents/commission\\_proposal.pdf](http://www.ecri.be/media/documents/commission_proposal.pdf).

62. Similar concerns buttress discomfort with usury laws. Indeed, this is a subject of much debate in Europe, where there is divergence of opinion regarding their utility between the United Kingdom (skeptical) and the continent (somewhat more receptive). See REIFNER ET AL., *supra* note 23, at 99 (“[Countries] have resumed the once abandoned price control on interest rates of the 19th century and given it a new philosophy: instead of hostility to credit and its supposed exploitative effects on labour it is now market failure for the weakest consumers which rule cost limitations.”). Usury law (or anatocism) has a rich history across many cultures. For example, although Islam provides for many alternative forms of banking, Shari’ah law prohibits the taking of interest or *riba*. See Aidit bin Haji Ghazali, *Consumer Credit from the Islamic Viewpoint*, 17 J. CONSUMER POL’Y 443, 449 (1994).

63. This is not a complete characterization of his nuanced proposal. He admits that much disclosure is in fact wrongheaded, such as the Truth in Lending Act’s preoccupation with credit card applications. MANN, CHARGING AHEAD, *supra* note 17, at 167. His proposed disclosure would occur at the purchase and billing stages. *Id.* at 176–81. Mann would also have easily priceable standardized terms posted on the Internet so the market (or at least net-surfing insomniacs) could discipline those terms. See *id.* at 162–65. Some in Congress appear to have taken heed of several of Mann’s sensible recommendations. See Credit Card Act of 2005, S. 499, 109th Cong. (2005) (requiring, among other things, bill cycle disclosure of minimum payment amortization period and payment required to amortize outstanding balance in three years); Consumer Credit Card Protection Act, H.R. 3492, 109th Cong. (2005) (proscribing universal default terms). Thankfully, Mann also thinks of the children. MANN, CHARGING AHEAD, *supra* note 17, at 172–73.

ing to consider alternative approaches to change current lending practices.<sup>64</sup> That is what the proposal in this article explores.

Before proceeding to the proposal, however, it requires reminder that there are other solutions to reckless credit than the imposition of private liability against reckless lenders. For example, one could disaggregate the problematic attributes of the consumer credit card market for targeted reform. Debiasing techniques, or discretion-stripping precommitment mechanisms to tie consumers to their masts *ex ante*, might address the problem of imperfect consumer heuristics.<sup>65</sup> And industry-targeted regulation or Pigouvian taxation might diminish the incentive of credit issuers to make their borrowers sweat a few years with high fees on loans with little chance of being repaid.<sup>66</sup> But the existence of these more specifically focused potential solutions does not preclude the possibility of other, more broadly aimed proposals (provided of course their potential as substitutes does not conspire to produce overdeterrence).<sup>67</sup>

64. Pessimism seems well placed given the disappointing success that warnings have had in overcoming human cognitive frailties in the products liability area of tort law. For an excellent analysis of these psychological traits, and corresponding criticism of tort law's preoccupation with exculpatory warnings, see Howard Latin, "Good" Warnings, *Bad Products and Cognitive Limitations*, 41 UCLA L. REV. 1193 (1994) (suggesting that the "mistake and momentary inattention" model better explains human conduct than the "rational risk calculator" model and criticizing comment J to section 402A of the *Restatement (Second) of Torts*). Latin's analysis of the psychological literature is thoroughgoing. He addresses such apparent conflicts as the inattention to low-probability risks and the overemphasis on high-salience examples. Also noteworthy is Latin's pointed critique of research downplaying the impact of information overload on consumers' processing of warnings. See *id.* (critiquing David M. Grenther et al., *The Irrelevance of Information Overload: An Analysis of Search and Disclosure*, 59 S. CAL. L. REV. 277 (1986)). For more sanguine treatment of the role of product warnings, see Alan Schwartz, *Proposals for Products Liability Reform: A Theoretical Synthesis*, 97 YALE L.J. 353 (1988).

65. See Brigitte C. Madrian & Dennis F. Shea, *The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior*, 116 Q.J. ECON. 1149, 1149–50 (2001); see also Richard H. Thaler & Shlomo Benartzi, *Save More Tomorrow: Using Behavioral Economics to Increase Employee Saving*, 112 J. POL. ECON. S164, S164–70 (2004). Professor Cass Sunstein applies this principle to borrowing in *Boundedly Rational Borrowing*, 73 U. CHI. L. REV. 249 (2006).

66. See MANN, CHARGING AHEAD, *supra* note 17, at 313 (citing unpublished manuscript of Professor Jason Kilborn describing Belgian law). Indeed, the Belgians have established a tax on defaulted debt, with the presumable intention of forcing lenders to internalize more fully their costs.

67. For example, the United Kingdom is (soundly) taking a "comprehensive approach" to tackling overindebtedness and has recommended a variety of legislative responses. See GRIFFITHS COMM'N, *supra* note 23, at 77. Most saliently, one of these reforms is expanding the grounds for privately enforceable relief from "unfair" credit transactions. See DEPT' OF TRADE & INDUS., FAIR, CLEAR, AND COMPETITIVE, *supra* note 23, at 52–54 ("The existing definition [of "extortionate" credit under the Consumer Credit Act] should be replaced with a test that would make agreements easier to challenge. . . . The courts have traditionally focused on interest rates charged under the agreement. . . . [However], unfair practices such as pressure-selling or the churning of agreements can cause detriment. New forms of lending have emerged where—whether through rogue trading practices or because of consumer ignorance or desperation—credit may be taken on terms . . . that appear unacceptable."). The Department of Trade and Industry's report ties this to the idea of "responsible lending," which should be considered in gauging liability for an unfair transaction. This practice (or, possibly, duty) encompasses "[t]he lender's care and responsibility in providing the credit—including taking reasonable steps to ensure a consumer's creditworthiness and ability to meet the full terms of the agreement at the time it was concluded." *Id.* at 57. Examples of other initiatives under the U.K.'s "comprehensive approach" include school curriculum modification, distribution of public literature, subsidy of community-based credit unions, and the imposition of cigarette-style "health warnings" on



In fact, at the broadest level of analysis, problems with reckless credit might be addressed by treating structural problems of health care and other more exogenous causes of bankruptcy,<sup>68</sup> or by trying to change social norms regarding consumption.<sup>69</sup>

Accordingly, the purpose of this article is not to suggest that lender liability is the only way of dealing with the reckless extension of consumer credit, or even necessarily the superior way. The goal is to suggest that private liability for reckless credit could help stem the troubling rise in consumer bankruptcies in a principled manner that deserves serious policy consideration.

## II. THE PROPOSAL FOR RECKLESS LENDING LIABILITY

The proposal for reckless lending liability to address the problematic aspects of consumer borrowing discussed above is actually inspired in part by Congress' architecture of BAPCPA. In its bill, Congress decided to use sticks, rather than carrots, as its motivational technique to bring down the number of bankruptcy petitions, and it did so by swinging those sticks at debtors. BAPCPA increases debtor punishment in several ways. It expands the types of debts no longer subject to the bankruptcy discharge.<sup>70</sup> It reduces the strip-down capability of debtors to mark to market certain secured consumer debts.<sup>71</sup> Most importantly, it strengthens the debtor's punishment for taking out improvident or "reckless" loans—debts for certain luxury goods that the debtor has no chance of repaying in light of his looming insolvency.<sup>72</sup>

This proposal builds upon Congress' stick fixation and seeming irritation with grossly improvident borrowing. It does so, however, by aiming those sticks at creditors, rather than debtors. Specifically, the envisioned liability would impose legal consequences on a lender who, like a debtor loading up on consumer goods when teetering on the brink of bankruptcy, extends credit when it knows, or should know with reason-

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credit card statements. See DEP'T OF TRADE & INDUS., TACKLING OVER-INDEBTEDNESS 2006, *supra* note 23.

68. See generally Melissa B. Jacoby, *Collecting Debts from the Ill and Injured: The Rhetorical Significance, but Practical Irrelevance, of Culpability and Ability to Pay*, 51 AM. U. L. REV. 229, 229–33 (2001); Melissa B. Jacoby et al., *Rethinking The Debates Over Health Care Financing: Evidence from the Bankruptcy Courts*, 76 N.Y.U. L. REV. 375, 375–78 (2001).

69. Todd J. Zywicki, *An Economic Analysis of the Consumer Bankruptcy Crisis*, 99 NW. U. L. REV. 1463, 1532–34 (2005).

70. See, e.g., BAPCPA, Pub. L. No. 109-8, §§ 220, 224(c), 310, 314, 119 Stat. 23, 59, 64, 84, 88 (codified at 11 U.S.C. § 523(a)) (expanding half the exceptions to discharge and adding three new exceptions); *id.* § 106(b), 119 Stat. at 38 (adding new objections to chapter 7 discharge); *id.* § 603(d), 119 Stat. at 38 (adding a new reason to revoke discharge).

71. See *id.* § 306(b), 119 Stat. at 80 (automobile debt).

72. See *id.* § 310, 119 Stat. at 84. Note that the most important structural change of the legislation, the means test of § 707(b), does not make this list of debtor punishments. The means test is harsh, but it is plausibly (albeit barely) defensible as progressive inasmuch as it treats poorer debtors more leniently than debtors who are less poor. It may be evil, but it cannot be said to have been designed to punish all debtors the way the examples in the text are broadly antidebtor.

able inquiry, that the debtor will be unable to service that debt in the ordinary course of his affairs.

The reckless lending defense (or cause of action) would belong primarily to the debtor, who is the one most directly harmed by the reckless conduct, although presumably standing could be extended to the debtors' other creditors (or even family members).<sup>73</sup> In the baseline version of the proposal, liability for breach of the effective duty of "prudent lending"<sup>74</sup> would result in a defense to collection outside of bankruptcy and a disallowance of a claim inside bankruptcy.<sup>75</sup> In its more aggressive form, the proposal would permit a court to award damages for consequential harm shown to be causally linked to the breach.

While the idea may at first sound novel to U.S. readers, it is far from unprecedented. The South African National Credit Act takes the contractual route and authorizes debtor relief for recklessly extended credit.<sup>76</sup> The French, by contrast, have used tort in their business realm;

73. See Countryman, *supra* note 13, at 19–20 (suggesting cause could be pursued by debtor's other creditors); see also Leonard J. Long, *An Uneasy Case for a Tort of Negligent Interference with Credit Contract*, 22 QUINNIAC L. REV. 235, 237 (2003) (suggesting that standing should *only* be granted to the creditors, and *not* to the debtor, because the harm, on one interpretation of the economic wrong, is principally against the debtor's creditors, not the debtor). Note that the practical effect of granting a cause of action to a debtor who is about to go bankrupt is that the benefit will inure primarily to the debtor's estate, which will effectively subrogate to the claim. See 11 U.S.C. § 541 (2000). The debtor will remain the residual claimant to the cause in the event of excess damages, but the likely effect is that damages will be paid into his estate for the benefit of his other creditors. This is one reason why the analysis in the text focuses mostly on the deterrent rather than compensatory functions of private remedies. For further consideration of the incentives debtors face to litigate in bankruptcy, see *infra* note 209.

74. The U.K.'s code of practice for banks and credit card issuers required a duty of "prudent marketing" inspired in part by a 1991 report, by the Director-General of Fair Trading, entitled *Unjust Credit Transactions*. See Geraint Howells, *Seeking Social Justice for Poor Consumers in Credit Markets*, in CONSUMER LAW IN THE GLOBAL ECONOMY: NATIONAL AND INTERNATIONAL DIMENSIONS 257, 271 (Iain Ramsay ed., 1997) [hereinafter CONSUMER LAW IN THE GLOBAL ECONOMY]. The DTI's Office of Fair Trading updated this report and made subsequent proposals to Parliament. These proposals do not appear to have been enacted yet, but they have found some outlet as Office of Fair Trading regulations. See, e.g., OFFICE OF FAIR TRADING, PROTECTING VULNERABLE CONSUMERS: A NOTE BY THE OFFICE OF FAIR TRADING IN RESPONSE TO THE DTI'S CONSULTATION DOCUMENT ON EXTORTIONATE CREDIT (2003), available at <http://www.oft.gov.uk/NR/rdonlyres/D7773AD7-C40A-49B6-A14B-A103D805D05C/0/Extcredit.pdf> (promoting duty of "responsible lending" and legal intervention in "unjust credit transactions"); OFFICE OF FAIR TRADING, NON-STATUS LENDING: GUIDELINES FOR LENDERS AND BROKERS (1997), available at <http://www.oft.gov.uk/NR/rdonlyres/56CF50D1-0728-47FF-89D4-069484DE7EED/0/oft192v2.pdf>. Also see the proposed E.U. Consumer Credit Directive that provided in its initial draft of Article 9: "Where the creditor concludes a credit agreement . . . he is assumed to have previously assessed, by any means at his disposal, whether the consumer . . . can reasonably be expected to discharge [his or her] obligations under the agreement." *Consumer Credit Directive*, *supra* note 61, at 40.

75. The preemptive power of federal law to do so might have to be located in the Commerce Clause rather than the Bankruptcy Clause, although the Bankruptcy Clause has found new constitutional life of late. See *Cent. Va. Cmty. Coll. v. Katz*, 126 S. Ct. 990, 1004 (2006) (holding that the Bankruptcy Clause grants Congress "the power to subordinate state sovereignty, albeit within a limited sphere").

76. See Republic of South Africa, National Credit Act 34 of 2005, available at <http://www.thedti.gov.za/ccrdlawreview/creditact2006.htm>. Section 80 of the Act defines "reckless credit" as credit offered when either the lender failed to conduct a proper credit screen (irrespective of what a properly conducted screen would have shown), see *id.* s. 80(1)(a); the lender conducted a screen but it suggested

they had an action (until quite recently) for “improper support,” under which a creditor who wrongfully extends credit to a debtor with the result of “artificially prolonging the life of the company” and protracting an inevitable default is held liable for the losses incurred by other creditors.<sup>77</sup> A fledgling analogue to this tort—“deepening insolvency”—is unfolding in the U.S. business reorganization field although it is still in its nascent stages.<sup>78</sup> More broadly, the European Union is in the midst of crafting a “responsible lending” duty within its revisions to its Consumer Credit Directive that would place possibly privately enforceable<sup>79</sup> legal duties on banks and other extenders of credit to take concrete steps to “lessen the risk of consumers falling victim to disproportionate commitments that they are unable to meet, resulting in their economic exclusion and costly action on the part of Member States’ social services.”<sup>80</sup> In-

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that the borrower was procedurally confused, i.e., “did not generally understand or appreciate . . . the risks, costs, or obligations under the proposed agreement,” *id.* s. 80(b)(i); or the lender conducted a screen but it suggested the debtor was substantively unable to service the debt, i.e., the loan “would make the consumer over-indebted,” *id.* s. 80(1)(b)(ii). Overindebtedness is found if the borrower “is or will be unable to satisfy in a timely manner all the obligations under all credit agreements to which the consumer is a party.” *Id.* s. 79 (requiring consideration of borrower’s “financial means, prospects and obligations”). Courts may set aside “all or part of the consumer’s rights and obligations” under a declared reckless credit contract “as the court determines just and reasonable in the circumstances.” *Id.* ss. 83(2)(a), 87(1)(b)(i). See generally Stéfan Renke et al., *New Legislative Measures in Australia Aimed at Combating Over-indebtedness—Are the Proposals Sufficient Under the Constitution and Law in General?*, 15 INT’L INSOLVENCY REV. 91 (2006).

77. See Paul J. Omar, *Reforms to Lender Liability in France*, 3 INT’L CORP. RESCUE 277 (2006) [hereinafter Omar, *Reforms to Lender Liability in France*]. The French doctrine of *soutien abusive* (improper support) “deems a credit-provider liable to other creditors for providing funds that lead to the continuation of business activity later deemed unlawful.” Paul J. Omar, *French Insolvency Law and the 2005 Reforms*, 12 INT’L COMPANY & COMMERCIAL L. REV. 490 (2005) [hereinafter Omar, *French Insolvency Law*]. As part of the recent overhaul to their commercial law, the French have partially abolished this action. This controversial move apparently was motivated in part by a concern that it chills workout financing. See *id.* For criticism of this French overhaul as hurried, see *id.*

78. See, e.g., Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., 267 F.3d 340, 349–51 (3d Cir. 2001) (recognizing tort of “deepening insolvency” under Pennsylvania law). To appreciate the flux in this area, consider the Third Circuit’s backpedaling when in a panel decision involving *Lafferty*’s author, it suggested that fraud-level scienter—not mere negligence—might be required to ground an action. See *Seitz v. Detweiler, Hershey & Assocs. (In re CITX Corp.)*, 448 F.3d 672, 680–81 (3d Cir. 2006) (dismissing complaint against debtor’s accountants alleging deepening insolvency). For an excellent discussion exploring deepening insolvency (and especially the problems posed for it by the doctrine of *in pari delicto*), see TaeRa K. Franklin, *Deepening Insolvency: What It Is and Why It Should Prevail*, 2 N.Y.U. J.L. & BUS. 435 (2006). As this article is going to press, the Delaware Chancery Court—racing to the bottom or top, depending on your view—has tried to eliminate this cause as a matter of state law. See *Trenwick Am. Litig. Trust v. Ernst & Young LLP*, 906 A.2d 168, 205 (Del. Ch. Ct. 2006) (rejecting “an independent cause of action for deepening insolvency” and counseling resort to a plaintiff’s “traditional toolkit, which contains, among other things, causes of action for breach of fiduciary duty and for fraud”); see also Jay R. Bender, *Deepening Insolvency In Alabama: Is It a Tort, a Damages Theory or Neither of the Above?*, 66 ALA. LAW. 190, 190–91 (2005) (discussing whether Alabama should recognize the tort of deepening insolvency).

79. See *infra* notes 81, 161 and accompanying text.

80. *Consumer Credit Directive*, *supra* note 61, at 8, 13–15. Professor Iain Ramsay discusses his proposal, in turn summarizing European commentators. See Iain Ramsay, *Comparative Consumer Bankruptcy*, 2007 U. ILL. L. REV. 241. One interesting (and ominous) point Ramsay makes is that the proposal “has been watered down in more recent drafts.” *Id.* at 254. Ramsay’s assessment is well taken. A full discussion of the ongoing legislative process of the Directive is beyond the scope of this article, but it suffices to say that from the Commission’s first draft of the Directive (which itself is a

deed, the Directive's concept of responsible lending, as an affirmative duty on credit providers, has a considerable European pedigree that is described in the E.U.'s Report.<sup>81</sup> Therefore, despite its possible novelty to U.S. policymakers, private liability for reckless lending has well-developed foreign cognates and seems to be gaining momentum.<sup>82</sup>

As mentioned, there is even some domestic history to this proposal. The idea of private liability for the improvident extension of credit has been percolating since at least the 1960s, although it appeared to fall into remission by the 1980s.<sup>83</sup> Professor Countryman raised it with the National Bankruptcy Conference in 1965.<sup>84</sup> It was also in the Uniform

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revision of the obsolete Directive of 1987), to its interim response to the Council, to its October 2005 second draft, many of the Directive's key provisions have been whittled away, including the responsible lending principle. The revisions have eliminated "Responsible Lending" as a caption and transformed it first into a "Duty to Advise" and then a "Duty to Provide Adequate Information," with an express admonition that consumers bear an ultimate duty of prudence. Indeed, the principle of responsible lending no longer includes a duty to assess, by national databases, a debtor's ability to repay. More generally, the ambitious scope of the proposal for strong harmonization has been replaced with a "partial" harmonization approach, further minimizing the Directive's potential impact. See *Modified Proposal for a Directive of the European Parliament and of the Council on Credit Agreements for Consumers Amending Council Directive 93/13/EC*, at 6, COM (2005) 483 final (Oct. 7, 2005) [hereinafter *Modified Proposal*] (stating that it is only necessary to consult databases "where appropriate"), available at [http://ec.europa.eu/consumers/cons\\_int/fin\\_serv/cons\\_directive/2ndproposal\\_en.pdf](http://ec.europa.eu/consumers/cons_int/fin_serv/cons_directive/2ndproposal_en.pdf).

It appears that the United Kingdom has been a driving force behind chipping away at the responsible lending article. See DEP'T TRADE & INDUS., PROPOSAL FOR AN EC CONSUMER CREDIT DIRECTIVE—SUPPLEMENTARY CONSULTATION 5, 13 (2006), available at <http://www.dti.gov.uk/files/file27459.pdf> (noting that the revisions have rendered the duty to advise "less onerous" and expressing "doubts about the value of a 'responsible lending' provision"). The U.K.'s position on the Directive is interesting, to say the least. The United Kingdom has at times seemed skeptical of a duty of responsible lending (which it has disparaged as "amorphous"), while at the same time expanding, on the domestic front, private law remedies for "unjust relationships between creditors and debtors" in the 2006 Consumer Credit Act. See Consumer Credit Act, 2006, cs. 19–22 (Eng.) (rewriting and expanding the "extortionate credit" sections of the Consumer Credit Act, 1974, c. 39, § 140A (Eng.)). The second version of the Directive proposal, ostensibly revised (more accurately, softened) in part to mollify the unenthusiastic British feedback to responsible lending, now seems to have caused a partial revolt back in London—as being too lenient on lenders! See Jane Croft, *Peers Hit at EU Move on Consumer Credit*, FIN. TIMES, July 6, 2006, at 2 (quoting Baroness Thomas, House of Lords E.U. Committee Chairwoman, as saying, "We are concerned that these proposals from the European Commission could undermine important consumer protection measures we have built up in the UK over many years"). The same article reports the unsurprising position of the British Bankers Association, which opposes the Directive outright. *Id.* Needless to say, the status of the E.U. Directive proposal remains uncertain at best. It is neither clear where it is going nor what the U.K.'s ongoing influence (if any) will be.

81. See REIFNER ET AL., *supra* note 23, at 100–01, 236 (noting significant national variation).

82. The analogue of this tort in other systems makes it difficult to raise the alarm that it would be a brazen new development that could wildly skew markets. See REIFNER ET AL., *supra* note 23, at 100–01 (providing examples of responsible lending remedies under national law). Indeed, wholly apart from deepening insolvency at corporate law, the consumer debt arena already countenances antideficiency statutes in secured credit markets. Many states have such laws and they have not traumatized the consumer lending world. See, e.g., James B. Hughes, Jr., *Taking Personal Responsibility: A Different View of Mortgage Antideficiency and Redemption Statutes*, 39 ARIZ. L. REV. 117, 120 (1997) ("Anti-deficiency statutes potentially relieve a consumer of the obligation to pay some or all of the portion of his indebtedness that exceeds the amount realized at the foreclosure sale."). For a skeptical assessment of the role these statutes play in protecting consumers, see James J. White, *The Abolition of Self-Help Repossession: The Poor Pay Even More*, 1973 WIS. L. REV. 503.

83. See Countryman, *supra* note 13, at 8–10.

84. See *id.*

Commercial Credit Code of 1968 (spearheaded by the ABA and NCCUSL).<sup>85</sup> And the National Consumer Law Center's Model Consumer Credit Act of 1970 included a comparable provision at section 8.104(2)(c).<sup>86</sup> All involved similar ideas. Countryman's proposal to the NBC was typical; it sought to amend then-Chapter XIII of the Bankruptcy Act to provide:

On application of the debtor and after hearing on notice to the creditor concerned, the court might determine that a claim, secured or unsecured, was based on "an improvident extension of credit in view of the information reasonably available to the creditor at the time of extending credit . . . ."<sup>87</sup>

Elaborating "improvidence," Countryman and John D. Honsberger, of the Canadian Study Committee on Bankruptcy and Insolvency Legislation, further proposed:

An "improvident credit extension" means an extension of credit to a debtor where it cannot be reasonably expected that the debtor can repay the debt according to the terms of the agreement under which the credit was extended in view of the circumstances of the debtor as known to the creditor and of such circumstances as would have been revealed to him upon reasonable inquiry prior to the credit extension.<sup>88</sup>

Countryman was not alone in his enthusiasm, and there were plenty of other similarly spirited recommendations. For example, recognizing the cumulative effect of indebtedness, Professor Wesley Sturges had previously proposed a FIFO system, charging subsequent lenders with knowledge of prior lenders' loans, such that each successive extension of credit would become increasingly unreasonable.<sup>89</sup> More rules-based readers might find interesting the suggestion of Richard Poulos (a bankruptcy judge in Maine at the time) that improvidence be calculated by taking federally garnishable wages, deducting the amounts required to amortize existing nonmortgage consumer debts over three years, and then declaring that any extension of credit in excess of this serviceable amount be

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85. See *id.* at 10–11 (seeking to enjoin the enforcement of loan provisions where creditor believed that "there was not reasonable probability of payment in full of the obligation" by the debtor (quoting Uniform Commercial Credit Code § 6.111(3)(a))).

86. See *id.* at 11. The Model Consumer Credit Act never really took off. The Act was in part a response to the Uniform Commercial Credit Code's perceived pro-creditor slant, but NCCUSL responded by revising the Uniform Commercial Credit Code in 1974. Only twelve states enacted the Code (seven the 1968 version and five the 1974 version). None enacted the Act.

87. *Id.* at 9.

88. *Id.* at 12. This formation captures much of the South African idea. See *supra* note 76.

89. See Wesley Sturges, *A Proposed State Collection Act*, 43 YALE L.J. 1055, 1079–80 (1934). Countryman discusses this proposal, sharing my concern over its attempts to deal with involuntary creditors. See Countryman, *supra* note 13, at 7–8. But it at least confronts the problem that cumulativeness is a large part of the reckless lending problem, so perhaps it reflects a sensible approach that simply needs some form of carve-out for certain involuntary creditors.

deemed improvident.<sup>90</sup> All these contributors were trying to operationalize the concept of creditor liability for what was viewed as the “overloading” of wage earners.

Indeed, there are countless ways to articulate a test for reckless lending. For the current discussion, it suffices to accept Countryman’s test, although this article proposes elevating the culpability to “recklessness” rather than “negligence.”<sup>91</sup> The consequence of finding an extension of credit reckless would be to bar enforcement of the contract (either completely or partially) in collection proceedings and disallow claims based on the contract in bankruptcy proceedings. (A more aggressive private remedy would be to allow a court, inside or out of bankruptcy, to award affirmative damages in tort for causally linked harm.)

The decision to follow Countryman’s preference for a standard (e.g., “recklessness . . . in view of the circumstances of the debtor”) over a rule (e.g., the Poulosian proposal of impermissibility if the debtor’s current garnishable income under federal law is insufficient to amortize outstanding debt in three years) may come as a disappointment to bright-line rule enthusiasts.<sup>92</sup> It is true that crisp rules accord greater clarity to lenders seeking safe harbor in designing their transactions than do standards. They may also permit readier *ex ante* implementation by a suitably funded regulator. But the looser approach of a standard, while necessarily sacrificing some precision, allows for flexibility in defining the contours of wrongful conduct in a context, such as reckless lending, where we may not yet know at this time where the ideal lines should be drawn.<sup>93</sup> Indeed, the Europeans’ palpable discomfort with the strictures

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90. See Countryman, *supra* note 13, at 12–13 (discussing Richard E. Poulos, Proposed Revisions for the Treatment of Unconscionable Claims in Chapter XIII Proceedings (1971) (unpublished paper prepared for the National Commission of Consumer Finance)). Note the implication that an amortization period beyond three years was suspect, which perhaps was premised on the estimated median lifespan of relevant consumer goods.

91. The reason it suffices for current discussion to accept Countryman’s definition is that this analysis is a first-cut attempt to introduce (or reintroduce) a novel concept into commercial law: defense in contract or liability in tort for improvident debt. Simply getting policymakers and scholars to think about this possibility is a precondition to ironing out the specific contours of how it might be best implemented. For discussion of the decision to elevate the requisite level of culpability, see *infra* text accompanying note 107.

92. See Countryman, *supra* note 13, at 122. Indeed, one colleague who read a draft of this article suggested updating the Poulosian rule to sixty months, which seems more in line with current legal repayment norms. See, e.g., 11 U.S.C. § 1325 (2000). I have no objection to such a temporally premised operationalization of “recklessness” in lending. I do want to be cautious, however, in reducing the concept to a bright-line rule at this early juncture. More importantly, I am not sure that standards and rules need be exclusive. One could have interpretive agency rules within a standard-based regime. Such a fusion could allow the promulgation of safe-harbor provisions (e.g., a rule that debt that can be amortized within sixty months on garnishable income is presumptively reasonable credit absent compelling evidence to the contrary).

93. To say there is a deep literature on the respective benefits of rules and standards is understatement in the extreme. Many books, see, e.g., H.L.A. Hart, *THE CONCEPT OF LAW* (1961), and articles, see, e.g., Roscoe Pound, *Hierarchy of Sources and Forms in Different Systems of Law*, 7 TUL. L. REV. 475 (1933), have constituted the scholarly journey. More recent contributions to this debate include Frederick Schauer, *Do Cases Make Bad Law?*, 73 U. CHI. L. REV. 883 (2006) (examining issue from a philosophical perspective), and Louis Kaplow, *Rules Versus Standards: An Economic Analysis*,

of bright-line rules seems to raise the additional concern that they might unfairly cut off access to credit. From the Commentary to the E.U. Directive comes the following exchange:

[W]ill the principle of responsible lending force credit companies to turn down loan requests from consumers with a high debt to income ratio, say over 50%?

... Looking specifically at the principle of responsible lending, all this requires is that credit companies carry out an honest assessment of the consumers' ability to make repayments. There is no threshold debt to income ratio implied in the principle.<sup>94</sup>

Accordingly, this article's proposal follows what appears to be the dominant approach and counsels a standard rather than a rule for the liability trigger.<sup>95</sup>

An important element of this suggested liability—which was wishfully styled “a new legal concept aborning” back in the 1970s—is how Countryman and his contemporaries initially linked it to the flexible and

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42 DUKE L. J. 557 (1992) (presenting an economic analysis). Professor Kaplow conceives rules as legal norms that are given content chiefly before pertinent actor conduct, and standards as legal norms where the upfront content-filling costs are deferred until after actor conduct. *Id.* at 562–63. He argues that rules, from a costs perspective, are desirable for widespread dissemination to multiple actors, whereas standards fit better with more idiosyncratic legal actors engaged in lower probability “risk” (technically, conduct implicating the desired norm). *See id.* at 585. The numbers/dissemination consideration suggests that rules would be preferable in combating reckless lending, but the countervailing consideration of waiting to gather postconduct information (e.g., the scope of harm caused) points to a standard. Note that, as Kaplow himself concedes, the difference between a rule and a standard is one of degree rather than kind, and even a seeming standard (e.g., vulgarity) can function as a rule if it carries appurtenant social understandings. *Id.* at 600–01.

94. Thorsten Muench & Catherine Bunyan, European Commission, Memorandum Regarding Questions and Answers on Consumer Credit 2 (Nov. 13, 2002), available at [http://ec.europa.eu/consumers/cons\\_int/fina\\_serv/cons\\_directive/ccd\\_qa\\_en.pdf](http://ec.europa.eu/consumers/cons_int/fina_serv/cons_directive/ccd_qa_en.pdf). The transformation of the duty of responsible lending into a chiefly procedural one of consulting available credit data rather than a substantive one (such as the duty to permit only debt that can be amortized fully within a fixed interval of time) is either the greatest weakness of the E.U. Directive or its greatest strength. On the one hand, the duty merely to consult the database prescribed by the first version of the Directive may accord the proper respect for freedom of contract that seems to underlie the concern with a bright-line rule's capacity to shut out certain borrowers. On the other hand, the procedural duty alone may prove hollow because it is difficult to imagine that even the most troublesome “sweatbox” lenders are not already availing themselves of a sophisticated array of credit score data. Indeed, the real problem is not that the lenders are ignoring data—it is that they are proceeding in the face of data that suggests an inability to amortize a loan within a reasonably short period of time. Perhaps, therefore, to give the European proposal real teeth, the “honest” in “honest assessment” must be given normative bite by interpreting courts. In any event, the second version of the proposal seems to have minimized, if not outright eliminated, the consultative duty, thus mostly mooted the issue for the time being.

95. It also bears mention that one proposed bright-line rule on reckless credit was quickly shot down in the BAPCPA debate, so standards may be more acceptable in an already hostile environment. *See Jensen, supra* note 3, at 506 (reporting failed amendment of Rep. Jerrold Nadler (D-NY) that would have disallowed claims in bankruptcy that “the claimant knew or should have known would cause, the debtor's aggregate unsecured debts to exceed 40 percent of the debtor's annual gross income”). Other such provisions met a similar fate throughout BAPCPA's tumultuous history. *See id.* at 565 (reporting, *inter alia*, failed 2005 amendments that would have disallowed claims with annual interest rate in excess of fifty percent and claims made by payday lenders to members of the armed services).

standard-based contract doctrine of unconscionability.<sup>96</sup> It bears remembering that at this heady time of the 1960s and 1970s, cases such as *Williams v. Walker-Thomas Furniture* were certainly in the public eye and not yet buried as casebook squibs.<sup>97</sup> Judge Poulos himself presided over the *Lowell* case, in which he disallowed a claim by a finance company that noted in its own file that the Lowells were “overloaded [and] can’t manage money. Always in fin[ancial] trouble,” yet were nevertheless approved for loans contractually requiring them to service \$600 of debt on \$780 of monthly income.<sup>98</sup> So it is unsurprising that Countryman’s original proposal, via the National Bankruptcy Conference in 1966, juxtaposed the suggested “improvident credit” disallowance rule with a sister disallowance rule for “unconscionable” claims.<sup>99</sup> This era’s skepticism toward the institution of contract could be what prompted Countryman to envision consumer credit overloading as analogous to unconscionable contracting.<sup>100</sup> Yet perhaps he also foresaw unconscionability getting mired in procedural focus (as it did),<sup>101</sup> and so proposed improvident credit as its own substantive vice, closely related to, but ultimately independent from, unconscionability.<sup>102</sup>

Whatever its theoretical soundness, the proposal’s link to unconscionability proved to be its undoing. By the time it found limited outlet in proposed section 4-403(b)(8) of the Bankruptcy Act of 1973 (what turned into the 1978 Code), it had been watered down to the unconscionability claim alone, and even that in turn was only a vague reference to state and other law.<sup>103</sup> Improvident credit disappeared as a standalone

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96. See, e.g., Countryman, *supra* note 13; Ronald L. Hersbergen, *The Improvident Extension of Credit as an Unconscionable Contract*, 23 DRAKE L. REV. 225, 286–95 (1974).

97. *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965).

98. *In re Lowell*, Nos. BK-70-1137/38 (D. Me. 1972), cited in Countryman, *supra* note 13, at 15.

99. Under the old Bankruptcy Act, state laws thrived in federal bankruptcy proceedings more than today’s limited outlet of exemptions. For example, states could set priorities and so it was perhaps natural that Countryman’s efforts were equally directed at state consumer protection laws, such as the Model Consumer Credit Act, which he assumed would apply in bankruptcy. See NAT’L CONSUMER LAW CTR., MODEL CONSUMER CREDIT ACT (1973), available at [http://www.consumerlaw.org/action\\_agenda/credit\\_code\\_archive/content/Consumer%20Credit%20Act%201973.pdf](http://www.consumerlaw.org/action_agenda/credit_code_archive/content/Consumer%20Credit%20Act%201973.pdf).

100. See Hersbergen, *supra* note 96, at 286–95.

101. See, e.g., 1 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 213–14 (4th ed. 1995) (distinguishing between procedural and substantive unconscionability); see also Hersbergen, *supra* note 96, at 286–95 (explicitly linking unconscionability to improvident extensions of credit). See generally Arthur Allen Leff, *Unconscionability and the Code—The Emperor’s New Clause*, 115 U. PA. L. REV. 485, 488 (1967) (bemoaning unconscionability’s “amorphous unintelligibility”). For a critique of the fixation with distinguishing procedural unconscionability (Leff’s “bargaining naughtiness”) from substantive unconscionability (Leff’s “lopsided terms”), see Robert A. Hillman, *Debunking Some Myths About Unconscionability: A New Framework for U.C.C. Section 2-302*, 67 CORNELL L. REV. 1, 2–3 (1981).

102. Hersbergen, *supra* note 96, at 295, examined the then-current contracts case law and found that improvident credit would at best be a supporting factor, but not a standalone ground, to buttress an unconscionability finding regarding a debt contract.

103. See Countryman, *supra* note 13, at 15. Specifically, section 4-403(c) sought to provide three “pertinent” considerations to the issue of unconscionability, the third of which was “definitions of unconscionability in statutes, regulations, rulings, and decisions of State and federal legislative, administrative, and judicial bodies.” *Id.* (quoting REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS



ground for disallowance. Yet the idea of unconscionability lurking beneath (or beside) liability for reckless lending remains relevant in at least two ways in reconsidering the proposal. First, it shows a moral dimension to the project, not purely an economic one, assuming, as I do, that the unconscionability doctrine has underpinnings beyond combating inefficiency.<sup>104</sup> Second, it underscores the contract-tort interface of the proposed liability.<sup>105</sup> Unconscionability is a doctrine that regulates the scope of private lawmaking under contract law, but it does so using standards of objectivized behavior borrowed from tort (e.g., whether the bargain shocks the reasonable person's objective conscience, whether the superior party knew or should have known of deficiencies of the inferior party, and so forth).<sup>106</sup> The decision to revive Countryman's proposal as one against reckless lending—not just improvident or negligent lending—is actually, in part, an attempt to reconnect to the more demanding threshold of the unconscionability doctrine, which is a cousin if not parent to this proposal in its contract form and a cognate to it in its tort one.<sup>107</sup>

In sum, somewhat like unconscionability, and perhaps even more so, the proposed liability for reckless lending—private liability regarding the origination and enforcement of a purportedly voluntary contract—occupies a position close to the contract-tort border of the legal landscape. In its stronger form, the proposal is for a tort cause. In its weaker form, it is for a contract defense. Either way, it seeks to attach legal consequence to a lender who allows the debtor contractually to borrow money when the lender knows, or was reckless to the probability, that the debtor could not afford to repay under ordinary circumstances. It

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OF THE UNITED STATES, H.R. Doc. No. 93-137, pt. 2, at 101 (1973)). Countryman's proposal preceded the 1978 Act. Doubtless he was disappointed none of these proposals survived.

104. See Robert Wisner, *Understanding Unconscionability: An Essay on Kant's Legal Theory*, 51 U. TORONTO FAC. L. REV. 396, 398 (1993) (arguing that unconscionability should be understood in light of Kantian philosophy).

105. Professor Leonard Long also embraces Countryman's cry for improvident lending liability, but from a strictly economic perspective. Implicitly recognizing the contract-tort interface of the liability, Long models his resurrection of Countryman's idea as building on the tort of intentional interference with contract (here, the intentional interference by the improvident creditor with the contract for credit between the debtor and the debtor's preexisting contractual lenders). Long, *supra* note 73, at 254-58. While Long's interpretation of the wrong is a little narrow in its focus (it ignores the ill effects on the debtor), its integration with the existing tort of intentional interference is helpful.

106. See RESTATEMENT (SECOND) OF CONTRACTS § 208 (1981). For recent treatment of unconscionability, and specifically of the role of consent, see Horacio Spector, *A Contractarian Approach to Unconscionability*, 81 CHI.-KENT L. REV. 95 (2006) (building on and refining Seana Valentine Shiffrin, *Paternalism, Unconscionability Doctrine, and Accommodation*, 29 PHIL. & PUB. AFF. 205 (2000)).

107. Retranslating the concept back to tort again, the tort law cognate of unconscionability might be the intentional infliction of emotional distress (at least the strand of those tort cases that focus on the subjective harm of the victim, not those that focus on the affront to the community's dignity). See generally *Nickerson v. Hodges*, 84 So. 37 (La. 1920) (allowing intentional infliction of emotional distress claim to proceed based on "humiliation" of practical joke where plaintiff's mental condition suggested she was not even aware she was being "humiliated" by putative jokers). One analysis has essentially viewed the business model of lenders as so fraudulent that it should be analogized to the intentional tort of deceit. See Harris & Albin, *supra* note 56, at 446.

targets credit of "tainted consent": credit that the debtor, properly informed and rationally deliberating, would never have incurred in the first place.<sup>108</sup>

### III. THE CASE FOR RECKLESS LENDING LIABILITY

The chief policy effect of lender liability is intended to be a restriction of "bad" credit. In clamping down on effectively unrepayable loans, liability will confront both of the major problems of the current credit card market: (1) the cognitive biases of borrowers who may not realize that some loans are unrepayable and (2) the socially inefficient and arguably "manipulative" business model of lenders who exploit those biases and do not care about the consequences. In short, it will throw water on an uncomfortably hot market.

The real question is how well it will put out the fire, or at least reduce it to a more manageable level. In proposing that privately enforceable liability against lenders for reckless loans may be a desirable regulatory mechanism, there are two axes of relevant consideration from a policy perspective. The first asks whether it is better to target debtors as Congress has done or creditors as this proposal would, taking the assumption that one wishes to reduce bankruptcy-causing loans. The second asks if one does decide that targeting creditors is preferable, whether there are better alternatives to addressing the problem than imposing private liability.<sup>109</sup>

#### A. Creditors Versus Debtors as Regulatory Targets

One attractive reason for holding creditors liable for bankruptcy-causing debt is a sense of fairness and symmetry.<sup>110</sup> It takes two to tango with reckless loans, and so holding the lender liable in contract or tort for these unreasonable extensions of credit places liability on the hitherto unblamed party to the transaction (in contrast to Congress' narrow focus on the debtor alone). This is not to deny the Coasian reality that many of those costs will find their way back to the borrower,<sup>111</sup> a point which is

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108. Thus, rather than *negating* tort liability (*volenti non fit injuria*), consent *predicates* it in this context by completing the circuit of a contract premised on defective consent. Such "imperfect" consent also serves as the justification for rescinding contractual obligation under the unconscionability doctrine, which, in a partially successful attempt to introduce clarifying nomenclature, Professor Richard Craswell calls "consent for purposes of contract law." Richard Craswell, *Property Rules and Liability Rules in Unconscionability and Related Doctrines*, 60 U. CHI. L. REV. 1, 40 (1993). Note that extortion is also an instance of flawed consent. It is not just a crime and contract defense but also, in some jurisdictions, a civil tort. See, e.g., *Zohn v. Menard, Inc.*, 598 N.W.2d 323 (Iowa Ct. App. 1999).

109. Of course, measures that target creditors will be passed along as price adjustments to debtors, but the allocation of default entitlement remains important in an imperfectly Coasian world. See *infra* note 111.

110. "[A]s with the Tango, it takes two to be improvident . . ." Countryman, *supra* note 13, at 17.

111. An economic analysis of this point occurs in Richard Craswell, *Passing On the Costs of Legal Rules: Efficiency and Distribution in Buyer-Seller Relationships*, 43 STAN. L. REV. 361 (1990) (model-

addressed in more detail below.<sup>112</sup> Rather, it is to make more transparent and explicit the identity of the problematic actor and get the emphasis off the much-maligned borrower. "Society should accept that consumer debtors who cannot repay their debts . . . are not always solely to blame and that the creditors . . . are not necessarily the only victims."<sup>113</sup> And data do suggest that the lending parties are not blameless in originating these loans.<sup>114</sup> In fact, data from Countryman's day suggested that far from being surprised that certain borrowers defaulted on their loans and ended up in bankruptcy, consumer lenders were recklessly indifferent.<sup>115</sup> For example, Professor Hersbergen's study of defaulting automobile loans in Des Moines found an astonishingly low inquiry rate of 32% for readily available credit bureau information, including some creditors who did not even bother to contact the credit bureau when a preliminary report issued the red flag warning "Contact Credit Bureau."<sup>116</sup> Indeed, there was evidence not just of creditor laziness but of affirmative abuse, such as deliberately procuring false statements from debtors so as to lay the trap of rendering their debts nondischargeable under the old Bankruptcy Act.<sup>117</sup> This behavior was and still is wrong. Thus, the value of sanctioning and redressing wrongful conduct by the lender, in contrast to Congress' punishing debtors, in and of itself provides compelling justification, from the perspective of balance, for this proposal. But the case for establishing liability against creditors for reckless lending is not simply to correct the expressive asymmetry of targeting debtors alone. It is built on the idea that creditors are likely to be more fruitful regulatory targets for reforming behavior.<sup>118</sup> This is evident for two primary reasons.

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ing that with homogenous consumer preferences, consumer-utility-maximizing terms will converge with Kaldor-Hicks efficient terms when full costs are "passed on to" consumers).

112. See *infra* Part IV.B.

113. REIFNER ET AL., *supra* note 23, at 36 (citing INT'L FED'N OF INSOLVENCY PROF'LS (INSOL), CONSUMER DEBT REPORT: REPORT OF FINDINGS AND RECOMMENDATIONS 14 (2001), available at <http://www.insol.org/pdf/consdebt.pdf> (providing that the first principle of consumer credit reform is a "fair and equitable allocation of consumer credit risks").

114. See KEMPSON, *supra* note 35, at 39-44 (quotation of banker conceding targeting of risky debtors).

115. Hersbergen, *supra* note 96, at 266-74.

116. *Id.*

117. See Robert Viles, *Non-Revolutionary Bankruptcy Act Proposed by the National Bankruptcy Commission*, 29 BUS. LAW. 1117, 1121 (1974).

118. Some judges have expressed support for creditor liability. See, e.g., *Cheshire Mortgage Serv., Inc. v. Montes*, 612 A.2d 1130, 1148-53 (Conn. 1992) (Berdon, J., dissenting). For an explicit rejection of Countryman's approach, also from Connecticut, see *Bankers Trust Co. v. Ellis*, No. CV010811511, 2002 WL 1370604, at \*2 (Conn. Super. Ct. May 22, 2002) ("[Countryman's] article presents an interesting academic concept that is not supported by any court decisions in Connecticut or in any other state.").

### 1. *Cognitive Bias*

The first reason comes from the lessons of behavioral psychology as evangelized to the law and economics movement. As referenced above in discussing the work of Professor Oren Bar-Gill and the ever-expanding corpus of literature upon which he builds,<sup>119</sup> consumers are worse decision makers than lenders when it comes to borrowing money.<sup>120</sup> Institutional, for-profit lenders should therefore have a better idea of how much money a given debtor can afford to pay on a monthly basis without suffering financial distress. This may seem counterintuitive. Surely the debtor has better access than the lender to the private information regarding what she can afford to borrow, such as the level of her future income stream. Among other factors, that income stream depends upon the debtor's employment plans, information which one would hope the debtor has better access to than the lender. The principal way the lender acquires that information is presumably from the debtor herself. Nevertheless, if the magnitude of the bias effects of myopia and optimism are significant (as Bar-Gill suggests they are),<sup>121</sup> then it could very well be that professional lenders are much better projectors of viable income repayment schedules than individual debtors, even if they have to incur the effort of extracting the inputs for those projections from the debtors.<sup>122</sup> This reasoning rests on the unusual position that your credit card company knows how much you should borrow better than you do, as expressly acknowledged by the Europeans:

A rational decision by the debtor requires a comparison between his own disposable income in the coming years and the installments which he has to pay. This is of course a primary duty of the debtor himself. But he will often not be able to do such a calculation. The concept of "responsible lending" . . . requires a minimum of such investigation, something already required in investment law.<sup>123</sup>

This may raise for some the specter of paternalism, but that will be addressed in due course. For now, it suffices to observe that if one wishes to attach legal consequence to making a loan that likely will end up causing bankruptcy, liability should fall on the lender as the more objective

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119. See *supra* notes 36, 38 and accompanying text.

120. Bar-Gill, *supra* note 36. REIFNER ET AL., *supra* note 23, at 107–30, has a rich, thoughtful discussion of the psychological impediments faced by consumers and the responses of various legal systems' attempts at debiasing, including, for example, the Swiss requirement of notaries and the French requirement of certain holographic contractual undertakings.

121. See Bar-Gill, *supra* note 36, at 1375 (arguing that consumers' behavioral biases result in the high levels of current credit card debt).

122. Built into this conclusion is the assumption that there is not systemic fraud (i.e., intentional misrepresentation) by debtors to lenders in credit applications. *But cf.* LoPucki, *supra* note 46, at 477–78 (suspecting systemic underreporting of assets in consumer bankruptcy petitions).

123. REIFNER ET AL., *supra* note 23, at 131. Note that even this assessment omits what is surely the case of disparate knowledge of relevant legal rules regarding consumer default, which again points to the lender's superior information role.

and rational actor;<sup>124</sup> borrowers may be, in products liability parlance, “undeterrable” (or at the very least “expensively deterrable”).<sup>125</sup>

## 2. *Cheaper Cost Bearers*

The second and related reason why it is more efficient to target lenders than debtors for improvident loan liability is that lenders are the cheaper and better situated parties to avoid a doomed loan in the first place, wholly apart from their superior cognitive capabilities.<sup>126</sup> Since the 1960s, commercial law commentators have emphasized the importance of access to information in calculating risk and pricing credit to consumers.<sup>127</sup> What were originally proprietary files of associations of the credit bureaus have blossomed into highly routinized credit scoring systems in the computer age.<sup>128</sup> Just this year, the three major credit rating agencies have announced that they will be moving to an even simpler, shared scoring system.<sup>129</sup> Is it contentious to suggest that the lending institutions themselves have better access to this information than the individual debtors?<sup>130</sup>

These data are often but not exclusively self-reported, so again the proposition must get past the awkward position that remote creditors are cheaper dealers of information than the primary sources of the information themselves. Yet this awkwardness is surmountable. The information costs are more than just the direct search costs of gathering the

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124. The role of the marketplace as an insufficient punisher of sweatbox lenders does not consider the role, if any, of underwriters as intermediaries. For example, I am informed that underwriters of consumer debt put out debtor quality guidelines based at least in part on capacity to repay. Conceivably these underwriters could assume a private regulatory watchdog function in a well-functioning marketplace.

125. See Hanson & Logue, *supra* note 31, at 1175. “Expensively deterrable” is preferred because presumably with constant monitoring, debiasing coaching, and other such fanciful mechanisms, borrowers could be deterred from falling into the sweatbox. Craswell implicitly captures the same idea when he characterizes certain contracts as “impossible” at gaining informed consent, because consent, while technically possible, would require excessively cumbersome and expensive explanations. See Craswell, *supra* note 108, at 8–12.

126. See generally GUIDO CALABRESI, *THE COST OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS* (1970).

127. See, e.g., Hersbergen, *supra* note 96, at 227 (documenting not the absence of the information but, by contrast, the ready availability of the information but disinclination of the lender to bother acquiring it).

128. One so inclined can get his FICO score online. See myFICO, <http://www.myfico.com> (last visited Nov. 19, 2006). Interestingly, much effort under both the U.K. consumer credit bill and the E.U. Directive focuses on the need to maximize the sharing of information (which may be a backlash against European privacy law).

129. M.P. McQueen, *Credit Bureaus Create Single Rating*, WALL ST. J., Mar. 15, 2006, at D4.

130. Readers inclined to worry about the slippery slope (i.e., that the same arguments for reckless lending liability can be marshaled against innumerable other contractual activities) should consult Hanson and Logue’s discussion of cigarette manufacturer liability—and one meaty footnote in particular. See Hanson & Logue, *supra* note 31, at 1352 n.784. Similar arguments regarding the intertemporal disconnect and systemic underrepresentation of risk that make the cigarette market atypical apply as well to the sweatbox lending market. Thus the slope may not be all that slippery on proper analysis.

debtor's relevant financial attributes.<sup>131</sup> Rather, they are the processing costs of storing and synthesizing these data that are relevant to the decision of whether to advance credit to a given debtor.<sup>132</sup> If you selected ten loan officers and ten debtors to study several financial profiles, the smart money would be on the ten loan officers to predict more accurately and quickly which profiles would ultimately default. It is not just that the debtors suffer from psychological impediments that have been systematically debiased in the professional lending setting. It is that they lack the capacity to store their own information, to access the information of other debtor-data points, and to understand enough about risk modeling to process that information anywhere nearly as efficiently as their institutional creditors.<sup>133</sup> That the pricing regime of the tripartite, constantly shifting consumer credit card contract is virtually unintelligible compounds this disadvantage that debtors find themselves in.<sup>134</sup> Indeed, Professor Geraint Howell's finding that six in seven debtors could not even define "APR" is sobering.<sup>135</sup> (It certainly augurs ill for a regime premised upon better disclosing APRs.)

The inferior capacity of consumers to gauge *financial* risk (as opposed to *product* risk) may be unique to the consumer credit market, where financing and product merge into one. Consider, for example, that when an individual consumer buys a television set, generally the consumer herself is better situated than the electronics store to know whether the purchase is affordable. To be sure, the consumer, due to various frailties and biases discussed, may have a poor idea at the precise moment of purchase whether she can afford the unit (she may even be

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131. See Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 594-95 (1984) (categorizing information costs into acquisition, processing, and verification costs).

132. More precisely, these costs affect the decision to set the cap on the line of credit in the tripartite rolling credit contract structure that leaves the ultimate debt decision to the consumer at the later times of purchase and repayment, rather than the initial time of contract term negotiation. See MANN, CHARGING AHEAD, *supra* note 17, at 128-34 (discussing unique contract structure to credit card open-end line agreement).

133. See *supra* text accompanying note 123.

134. See MANN, CHARGING AHEAD, *supra* note 17, at 25-30. One reason Mann supports market-based disclosure approaches to the problems of consumer credit overindebtedness is his ardent desire to avoid the moral quagmire that this article later confronts. See *id.* at 70 ("My approach is intended to be consciously amoral. I am not concerned about the weakening of moral fiber evidenced by some lowering to the stigma of bankruptcy nor by the callousness of standing by while large portions of our citizenry sink into irredeemable distress. My interest is solely economic."). It is thus not the price of credit that pops Professor Mann's eyes as grossly unfair to consumers; it is the inability of even diligent consumers to price it. See *id.* at 161-62. Note that even Mann cannot escape unfairness concerns. See *id.* at 167.

135. See Geraint Howells et al., *Credit Card Debt: Choices for Poorer Consumers*, in ASPECTS OF CREDIT AND DEBT 30 (Geraint Howells et al. eds., 1993). Equally sobering was Kripke's finding back in 1968 that professional graduate students of his near-acquaintance had no idea that consumer installment debt could result in legal liability for unpaid debt beyond repossession. See Homer Kripke, *Consumer Credit Regulation: A Creditor-Oriented Viewpoint*, 68 COLUM. L. REV. 445, 481 n.104 (1968). See generally Mitchell Pacelle, *Banks Profiting More from Confusing Card Fees*, WALL ST. J., July 11, 2004, at A16 (reporting that the average credit card agreement "ballooned from little more than a page 20 years ago to 30 pages or more of small print today").

“manipulated” into buying the unit by subtle psychological forces), but surely she has a better intuition than the arms-length merchant who has never met her before.<sup>136</sup> By contrast, the whole point of a credit review, at least in a properly functioning, nonsweatbox credit market, is for a lender to gauge the risk of lending money to a consumer debtor who has disclosed all relevant information. The credit provider, unlike the television merchant, is therefore supposed to be specifically interested in assessing whether the debtor can afford the product: price and product are one.<sup>137</sup> Thus, it is not unreasonable to predict that in the credit marketplace, in contrast to other mass-consumption ones, the merchant actually is the superior party in making affordability calculations. A for-profit lender takes risk in pricing the credit,<sup>138</sup> and risk itself requires *ex ante* uncertainty,<sup>139</sup> such as, for example, the future financial circumstances of the debtor. The argument is not that the lender is an omniscient information holder; rather, the argument is that the lender has better and less costly access to information regarding the affordability and serviceability of the debt.

The debtor’s comparative cognitive deficiency and the lender’s comparative information advantage are two important reasons why Congress should have directed policy interventions at creditors rather than debtors in reforming bankruptcy law. Such intervention is warranted from an efficiency standpoint alone, wholly apart from the expressive advantages. For these (and other) reasons, debtor-targeted bankruptcy reform was ill advised.

### B. *Private Liability Versus Other Regulatory Measures*

The preceding Section offered several reasons why creditors, rather than debtors, might have been the better targets of incentive-shaping bankruptcy reform. This Section considers whether private liability is a

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136. If the consumer is taken advantage of, as is presumed with a grossly disproportionate price, the doctrine of substantive unconscionability permits rescission of contract. *See, e.g., Jones v. Star Credit Corp.*, 298 N.Y.S.2d 264, 266 (N.Y. Sup. Ct. 1969) (price term alone rendered contract unconscionable); *Toker v. Perl*, 247 A.2d 701, 703 (N.J. Super. Ct. Law Div. 1968) (same). *But cf., e.g., In re Colin*, 136 B.R. 856, 858 (Bankr. D. Or. 1991) (price term alone does not warrant a finding of unconscionability). Usury law similarly prohibits unconscionably disproportionate price of credit.

137. Thus, generic consumer protection laws sometimes provide poor templates for credit regulations, because they are usually premised upon the idea that the sources of unfairness are ancillary terms described in small print, with adhesion, and so forth. Obfuscation of price arises as an afterthought. *See, e.g., Council Directive 93/13, Unfair Terms in Consumer Contracts*, art. 2, 1993 O.J. (L 95) (EU) (“Assessment of the unfair nature of the terms shall relate neither to the definition of the main subject matters of the contract nor to the adequacy of the price . . . in so far as these terms are in plain intelligible language.”).

138. Professor Long makes this point in his economic analysis. *See Long, supra* note 73, at 251.

139. Actually, risk and uncertainty are discrete probability concepts. *See generally* Omri Ben-Shahar & John Pottow, *On the Stickiness of Default Rules*, 33 FLA. ST. U. L. REV. 651 (2006) (exploring different social-psychological constructs involved in status quo stickiness).

sound approach to pursue in the first place.<sup>140</sup> It will be comparatively brief, however, because this article does not take the position that private liability is unambiguously the superior regulatory mechanism for restricting the supply of harmful consumer credit. On the contrary, it takes the more limited stance that private liability—whether through a reduction of contract collection or through exposure in tort—is a plausible regulatory avenue that deserves a seat at the policy prescription table. Private relief is meant to be a complementary, not exclusive, proposal.<sup>141</sup> In the same way that regulatory speeding laws, criminal liability for vehicular manslaughter, and tort liability for automotive negligence—provided that they are integrated so as not to overdeter—all can play a role in addressing the dangers of harmful driving, so too can multiple approaches combat the scourge of reckless credit.<sup>142</sup>

There are nevertheless two important considerations that warrant reflection in comparing private liability to other regulatory possibilities. First, the closest alternative to this proposal in outcome effect is a Pigouvian tax on distressed debt, along the Belgian model.<sup>143</sup> Following Professors Hanson and Logue's refinement to Professor Shavell's taxonomy, this would be a (state-initiated) *ex ante* incentive-based policy intervention as opposed to a (victim-initiated) *ex post* incentive-based one.<sup>144</sup> Professor Mann has endorsed, although not trumpeted, such a tax.<sup>145</sup> Both the imposition of private tort liability and a distressed debt tax would have the same incentive effect of chilling the sweatbox model and forcing lenders to internalize more of the deleterious effects of their lending relationship. A tax would also have the pragmatic advantage—in contrast to recent state law innovations that crack down on predatory lending—of being immune from preemption by hostile federal adminis-

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140. As discussed below, one of the reasons I find the contract doctrine of unconscionability and tort law generally attractive is that in addition to their regulatory effect on chilling reckless lending—which a tax might similarly do—they have the added benefit of legally recognizing a private, personal wrongdoing against the debtor by the lender. See John C. P. Goldberg, *Twentieth Century Tort Theory*, 91 GEO. L.J. 513, 525 (2003).

141. For recognition that different legal interventions (such as government taxation and enterprise liability in tort) can work as complements, see Hanson & Logue, *supra* note 31, at 1271 n.447.

142. This follows the path of current reform efforts that adopt a holistic and “comprehensive” approach to overindebtedness. Indeed, the U.K. plan involves expanding civil liability for “unfair” credit contracts in conjunction with changes to substantive insolvency laws, publicly funded education efforts, increased contribution to the Social Fund, and so forth. Professor Mann himself, in a recent piece, also sees the benefit of parallel reform efforts. See Ronald J. Mann, *Optimizing Consumer Credit Markets and Bankruptcy Policy*, 7 THEORETICAL INQUIRIES L. 395, 426 (2006) (advocating bankruptcy priority subordination rule for credit cards “as an adjunct to a tax on distressed debt”).

143. See *supra* note 66; see also Hanson & Logue, *supra* note 31, at 1268–71 (describing a Pigouvian tax). More precisely, this Pigouvian tax approach would be the closest policy analogue if the externality problem were taken as the dominating concern (in which case, the strongest version of private liability—tort—would be indicated).

144. See *id.* at 1263 n.423 (noting differentiation between state-initiated and privately initiated regulation in SHAVELL, *supra* note 12); see also *id.* at 1263 n.422 (comparing incentive-based, performance-based, and command-and-control regulation (citing SUSAN ROSE-ACKERMAN, *RETHINKING THE PROGRESSIVE AGENDA: THE REFORM OF THE AMERICAN REGULATORY STATE* (1992))).

145. MANN, *CHARGING AHEAD*, *supra* note 17, at 214–15.



trators under the National Bank Act because states retain the sovereignty to tax residents within their jurisdictions.<sup>146</sup> Indeed, a tax might even be a preferable response in light of arguably lower administration costs than a victim-initiated liability regime<sup>147</sup> (implicating one of the perceived advantages of rules to standards).<sup>148</sup>

A countervailing consideration, however, is that for a tax to be effective it must be broadly administered. Under such a broad application, the tax would likely catch “good” high-risk debt as well as “bad” high-risk debt even though it is the latter type of debt that is linked to increasing bankruptcy rates.<sup>149</sup> This is a similar overbreadth problem with a

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146. See generally Nicholas Bagley, *The Unwarranted Regulatory Preemption of Predatory Lending Laws*, 79 N.Y.U. L. REV. 2274 (2004); Christopher R. Childs, *So You've Been Preempted—What Are You Going to Do Now?: Solutions for States Following Federal Preemption of State Predatory Lending Statutes*, 2004 B.Y.U. L. REV. 701.

147. Comparative costliness of private enforcement is implicitly conceded for discussion only (and even this concession omits the upfront cost of determining the content of the legal norm). If one did want to engage in a comparative cost assessment, it is by no means clear that a private liability regime would be less efficient than, for instance, ex ante agency regulation by the Comptroller of Currency. First, it is at best an ambiguous case whether a public agency's enforcement budget would be more economical in terms of social welfare in overseeing reckless lending than the financial incentives of private attorneys general. Cf. Reinier H. Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 YALE L.J. 857, 884 & n.79 (1984) (considering costs and benefits of “contracting out” detection function of corporate delicts to private plaintiffs (citing William Landes & Richard Posner, *The Private Enforcement of Law*, 4 J. LEGAL STUD. 1 (1975))). Indeed, the Europeans have expressed pointed skepticism:

But increasingly there are doubts as to whether these [public regulatory] institutions will be able to cope with a more complex and remote practice in a market which is partly beyond their reach.

Fewer staff for such administration, and the large amount of potential infractions might limit effectiveness. . . . This is why the consumer himself is required to act as supervisor and attorney general in his own interest.

REIFNER ET AL., *supra* note 23, at 134 (proceeding to add further complexity that overindebted consumers are ironically often “in the worst position to act as private attorney generals,” such that even further incentives and facilitations are required, such as authorizing class-action legislation). Second, because the prototypical invocation of this liability would be in bankruptcy court (under either the ordinary contract or more aggressive tort versions of the proposal), there are certain litigation costs that have been “sunk” already: counsel has been retained by both debtor and creditor, and the litigation machinery has been invoked. For some of the same reasons this proposed action would be an unlikely profit center for the tort bar, see discussion *infra* Part IV.B, the marginal costs of resolving a reckless lending dispute (especially with the more modest version of the proposal) within a debtor's bankruptcy proceeding are likely to be minimal and may be much lower than staffing the Comptroller of Currency's office with more oversight lawyers. Indeed, on ultimate reflection it is not at all clear that staffing and administering a tax collection office is all that inexpensive a regulatory option in the first place.

As for the broader concern of the institutional competence of (diffuse and sometimes error-prone) judges and juries versus (capturable and sometimes indifferent) bureaucratic mandarins, their respective strengths vary in part based on whether one implements a rule or a standard, and this proposal currently favors a standard—which permits deferring delineation of the precise scope of the legal norm until further information, such as, importantly, the debtor's contribution to default, has been acquired. See Kaplow, *supra* note 93.

148. See Kaplow, *supra* note 93, at 568–70 (inferring that rules have lower administration costs although more precisely noting that rules front load resources in determining the content of the legal norm before applicable regulated conduct unfolds). For skepticism of courts' utility in policing consumer contracts, see Schwartz, *supra* note 64, at 382–92.

149. Even a tax on debt in default is overbroad if one assumes that some default is only temporary. In essence, the problem with a fixed-rate Pigouvian tax is that it must peg to the average care and activity level. See Hanson & Logue, *supra* note 31, at 1269.

usury-based approach to regulating consumer overindebtedness, which has been noted by others.<sup>150</sup> By contrast, individual private liability for reckless lending has the case-by-case advantage of only redressing and deterring loans that do, in fact, end up proving harmful.<sup>151</sup> This is not an endorsement of hindsight bias—it is a recognition that liability requires harm.<sup>152</sup> Thus, the comparison of a private law approach versus a regulatory tax may simply devolve into consideration of the traditional tradeoff between individual accuracy and efficient administrability.<sup>153</sup> The more significant problem with a tax approach, however, is the elephant that stalks every Pigouvian tax room: the rate at which to set the optimal tax. The uncertainty over the magnitude and scope of the reckless lending problem makes calibrating optimal social care and activity (through command-and-control regulation or its monetization as a Pigouvian tax) daunting indeed.<sup>154</sup>

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150. See, e.g., James J. White, *The Usury Tromp L'oeil*, 51 S.C. L. REV. 445 (2000).

151. SHAVELL, *supra* note 12, at 281, also makes the point that ex post regulation is preferable when injurers are likely to have superior information to a public regulator regarding the risks and costs of the impugned activity, a plausible assumption in the consumer lending market.

152. The harm element of the tort is most likely general default. Some might fret that linking the liability-triggering harm to conduct—default—that may be within the debtor's control, especially in a predominately self-filing, voluntary bankruptcy system, raises concerns of moral hazard. Such worry is probably unwarranted. Notwithstanding Congress' exhortations, the data assembled in SULLIVAN ET AL., *supra* note 25, suggest few welcome a filing for bankruptcy. Accordingly, it seems unlikely debtors will slide into bankruptcy strategically to "prove" (subscribing to hindsight bias) that the credit load they were extended was reckless and caused them harm. Indeed, note in this regard that subsequent to the introduction of changes to the insolvency law under the Enterprise Act of 2002—which generally made insolvency procedure more lenient but did not affect the cognate procedure of individual voluntary arrangements (IVAs)—both the number of insolvencies and the number of IVAs went up, with IVAs actually rising in proportionate percentage terms. See DEPT' OF TRADE AND INDUS., OVERINDEBTEDNESS MONITORING PAPER Q1 2006, at 12 (2006), available at <http://www.dti.gov.uk/files/file31269.pdf>. Data such as these tend to scuttle the view that consumer debtors are subject to strategic ex ante opportunism regarding the content of bankruptcy laws.

153. This discussion omits an analysis of insurance. Part of this omission stems from the already ambiguous role bankruptcy law itself plays as public insurance for financial default. On the one hand, consumer bankruptcy law serves as public (and hence acutely externality-susceptible) insurance for financial distress—a marginally more robust insurance than the general welfare safety net. On the other hand, bankruptcy filers reporting miserable experiences suggests that the insurance "coverage" is parsimonious at best. Conceivably, a well-calibrated insurance product (presumably crafted for lenders as the more rational risk predictors) could at least transfer the costs of default back to the private parties. To create proper incentives for such a private product, either government command would be required (mandatory insurance) or risk exposure must be set high enough (i.e., adoption of the strong, tort version of the proposal) to overcome lenders' incentive to prefer the public bankruptcy system as an "externalized" form of insurance. For a discussion of the role of insurance in the face of the possible liability proposed in this article, see Harris & Albin, *supra* note 56. Professor Kraakman also considers instances in which insurance would undermine normative and other components to certain (mostly criminal) legal rules. See Kraakman, *supra* note 147, at 877 & n.57.

154. The case for ex ante regulation may seem at first blush to be stronger for performance-based standards. That is, the legislator could simply charge commercial lenders, as an industry, with reducing the number of bankruptcies. The problem, however, is that a penalty would have to induce compliance (e.g., proscribing credit cards), which, for the considerations discussed *supra* text accompanying note 62 and *infra* text accompanying notes 210–22, would largely throw the baby out with the bathwater.

Second, perhaps the greatest advantage of the private approach is its inherent normativity.<sup>155</sup> The normative pinch exists, albeit perhaps to differing degrees, in both the cautious (contract) or aggressive (tort) version of this proposal. For ease of exposition, this discussion will consider the liability from the perspective of a tort, although the same observations apply to the application of certain forms of contractual relief, such as unconscionability.<sup>156</sup> When someone commits a tort, he has wronged someone else. This means at least two things: the tortfeasor has done something wrong by violating a socially recognized duty, and he has done something wrong to someone who deserves private redress, wholly apart from any related harm to the community.<sup>157</sup> Accordingly, by tarnishing a lender with the reputation of having made a reckless loan, we, as a society, are saying with a clear voice that it is wrong that the debtor went into bankruptcy, and that the fault of that calamity lies chiefly with the lender of the improvident debt.<sup>158</sup> Thus, even approaches that may arguably achieve the same deterrent effect, such as a tax, may not carry the same imprimatur of private harm and disapprobation, which this article contends is warranted. The sweatbox is not only hot, it is smelly.<sup>159</sup> The institution of tort recognizes not just the negative externalities imposed by the lender's business model (in its public focus), but also the responsible role the lender has taken in wrongfully ruining the debtor's life (in its private focus).<sup>160</sup>

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155. Indeed, the expressive component to the E.U. Directive was noted by Professor Iain Ramsay, who observed that the proposal came out of an increased focus on corporate responsibility and the appropriate culture of the business marketplace, which is unsurprising in a post-Enron world. See Ramsay, *supra* note 80, at 254–55.

156. The opprobrium of breaching social norms discussed in the text is surely present in the finding that the counterparty has secured consent (or flawed consent) to an unconscionable contract, although even unconscionability itself may come in varying grades of “culpability.” See Craswell, *supra* note 108 (ranking, hierarchically, “property rule” and “liability rule” unconscionability by differentiating the “injurer’s” lessening degree of fault). *But cf.* RESTATEMENT (SECOND) OF CONTRACTS § 208 cmt. g (1981) (disclaiming “penal” element to the unconscionability doctrine).

157. This conception of the principles of tort liability, in relying upon duty and private nexus, might actually be a throwback to the “traditional account” of tort from centuries past, where the moral duty requirement was not an awkward component to be explained away by more modern, objective thinking. See Goldberg, *supra* note 140. Note that under more contemporary theories of tort (e.g., the Enterprise Liability Theory), the policy analysis alone of negative externalities makes the case for a tort. Thus, by further contending that private duty is implicated by the lender’s conduct, this article tries justifying the creation of a new tort under a more stringent standard than mere economic desirability.

158. Issues of the debtor’s contributory negligence are discussed below. See *infra* text accompanying notes 185–201.

159. This interest in normativity is why this discussion has largely eschewed a protracted institutional competence analysis. Arguing that there are cheaper and more efficient ways to regulate reckless credit, even if true (which is not conceded, see *supra* note 151), misses the mark by ignoring the equally important normative and expressive role of tort law (or the unconscionability doctrine) in vindicating the rights of the individual debtor.

160. See Goldberg, *supra* note 140. The deontological case probably varies as a function of the culpability of the wrongful actor, making tort law’s expressive role more important for intentional torts than mere negligent ones—another reason why this proposal seeks to ground liability only in reckless conduct.

Imposition of tort liability for private harm, unlike the dry imposition of a tax, requires the recognition of a duty owed by the lender to the debtor. Such a duty of responsible lending may require altering existing tort law. To be sure, the European Union proposed recognizing such a duty (albeit a statutory one) in the first draft of its Consumer Credit Directive,<sup>161</sup> but the common law may need some adjustment. Nevertheless, it is not clear that the common law would have to stretch so far. Consider in this regard what is likely to be the primary stumbling block for tort theorists: the somewhat removed (and dutiless) relationship merchants traditionally enjoyed, and still largely enjoy, at tort law. For example, in the classic rescue case of *Osterlind v. Hill*, the court found that the merchant had no duty to rescue a drowning canoeist, even though the merchant rented him the canoe knowing that the canoeist was drunk.<sup>162</sup> The business of boat renting did not subsume the perilous duty of being a lifeguard. Part of the reason for finding no duty might have been that a boat-letting enterprise's business thrives when customers return alive.<sup>163</sup> By contrast, with the sweatbox model of credit card lending, the consumer becomes even more profitable by going into default and triggering lucrative penalty interest rates. Drowning is not just tolerated, but welcome. Thus, the extension of a tort duty to "rescue" to such a lender who has used the debtor seems appropriately distinguishable from the situation in *Osterlind*. It is not just the lender's subjective elation at realizing a profit as a result of a consumer's demise that justifies the distinction;<sup>164</sup> it is the affirmative conduct of the lender in deliberately targeting, by analogy, poor-swimming borrowers in carrying out its business plan.<sup>165</sup> Passive canoe renting is fine, even if to visibly drunk canoeists (at least arguably under current doctrine).<sup>166</sup> Trawling for drunks or escorting them into a canoe when they are stumbling around the dock is not.<sup>167</sup>

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161. Note that its remedial provision, while vague, does suggest that the duty would be privately enforceable. See Council Directive 2006/49, art. 22, 2006 O.J. (L 177) 201, 210–11 (EC). This is even so as the specific illustrations of private remedies were deleted.

162. 160 N.E. 301 (Mass. 1928).

163. See *infra* note 164.

164. See John C.P. Goldberg & Benjamin C. Zipursky, *Duty and the Structure of Negligence*, 54 VAND. L. REV. 657, 704 (2001) (noting that "whether the defendant stood to profit from his interactions with the plaintiff" is relevant in finding an affirmative obligation of duty). As an example of this thinking in the duty case law, see, for example, *Burkhardt v. Harrod*, 755 P.2d 759, 761 (Wash. 1988) ("[T]he commercial proprietor has a proprietary interest and profit motive[] and should be expected to exercise greater supervision than in the (non-commercial) social setting.").

165. See Goldberg & Zipursky, *supra* note 164, at 740 (noting factors include "the extent to which social norms treat the conduct demanded of the defendant as required rather than merely advisable" in finding a duty). Note that if the lenders were forced to repackage their loans more transparently (for example, were forced to charge 49% interest out of the gates and could not use contingent and difficult-to-monetize fees), it is unclear whether they could scoop in so many borrowers. On the one hand, the demand seems fairly inelastic, but on the other, many "burnt" debtors—subject, of course, to necessary self-report bias, complain that they would have never gotten into their problems had they known the true terms of their loans.

166. Duty seems to be relieving the merchant of liability. From a strict policy perspective, it would be easy to defend the imposition of liability (cheapest cost avoider). Thus, it must be the distinct doctrinal role of personal duty that justifies (if it remains justified) the absence of liability in this

Negligent entrustment cases that historically hold no duty on financiers or entrusters to the ultimate victims of accidents are also properly distinguished. A striking example of such a case is *Peterson v. Halsted*, in which the parents of a known drunk driver, who cosigned a loan that enabled her to purchase the car that she ultimately drove drunk into an accident, were held to owe no duty in negligence to the victim.<sup>168</sup> The common law thus holds traditional financiers dutiless to the victims of their borrowers, even if they know their borrowers are likely to put their funds to “hazardous” purposes.<sup>169</sup> But in the untraditional world of sweatbox lending, where the financier actually solicits, through targeted mailings, debtors who will have a hard time repaying, the imposition of a tort duty seems not only permissible but normatively desirable. In this scenario, the financier’s actions are more directly linked to the ultimate harm.<sup>170</sup>

In sum, while other proposals may achieve a similar regulatory goal, private liability for reckless lending has the additional advantage of both greater individual accuracy and the recognition of a private harm (not just third-party ills) inflicted on the debtor by the lender: a personal, in addition to a social, problem.

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case. To be sure, however, the analysis is complex because foreseeability, which would likely on its own justify liability against the merchant from a policy perspective, is also involved in the very determination of duty. See *id.* at 727 (“Foreseeability is in the language of duty, the language of breach, and the language of proximate cause.”). With regard to duty in particular, foreseeability “plays a special role . . . but it is not the only question.” *Id.* For an example of a case putting this rule into sharp relief, see *Harper v. Herman*, 499 N.W.2d 472 (Minn. 1993) (holding that defendant had no duty to warn a guest diving off defendant’s boat into shallow water even if defendant knew of shallow water because defendant had no special relationship with guest giving rise to duty to warn). Codifying a duty to warn, the British have proposed legislation for “health warnings” on credit card statements “highlighting the risks associated with repeatedly paying the minimum repayment only.” DEP’T OF TRADE & INDUS., TACKLING OVER-INDEBTEDNESS 2004, *supra* note 23, at 33. For a contemporaneous student analysis of reckless lending from a products liability perspective, see Adam Goldstein, *Why “It Pays” to “Leave Home Without It”: Examining the Legal Culpability of Credit Card Issuers Under Tort Principles of Products Liability*, 2006 U. ILL. L. REV. 827. For analysis of warning efficacy, see Latin, *supra* note 64.

167. See *Harper*, 499 N.W.2d at 474–75 (implying conduct by defendant could give rise to special relationship justifying duty).

168. 829 P.2d 373, 377–78 (Colo. 1992).

169. Of course, these generalizations of private tort law are often altered by statute. See, e.g., Comprehensive Environmental Response Compensation and Liability Act (CERCLA), 42 U.S.C. §§ 9601–9675 (2000).

170. As mentioned, imposition of this duty may require some advancement of current U.S. common law of tort, and arguments for that movement have been made in the text. If pressed by the skeptical duty-doctrinalist, those duty arguments can always be jettisoned, and the case for recognition of the tort can be premised on social policy grounds alone (enlisting tort plaintiffs as instrumentally efficient private attorneys general). The attempt to engage the role of duty in tort—unlike Mann’s flight to moral agnosticism, see Mann, *Cards, Consumer Credit & Bankruptcy*, *supra* note 17, at 5—is animated by the belief that the lender’s conduct in these circumstances is not just inefficient but also wrong, in a personal way, against the debtor, and thus that a legal duty is not only defensible but appropriate.

## IV. POTENTIAL PROBLEMS (AND REPLIES)

The superior skills, resources, and cognitive dispositions of lenders make a strong case for Congress to swing its sticks at them in patrolling the reckless extension of credit. Yet this has not happened. Leaving aside explanations of public choice,<sup>171</sup> one can anticipate at least two serious problems that skeptics might have.<sup>172</sup>

## A. Causation

The first and thorniest issue is causation. Actually, the issue can equally be framed as one of causation or of fault, because both constructs—at least in this specific context—pertain to the problem of multiple inputs to the perceived harm. That is, a difficult problem with holding the lender liable for the consumer's financial default is that

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171. See Posting of Elizabeth Warren to Warren Reports on the Middle Class, <http://www.tpmcfe.com/story/2005/9/22/151914/605> (Sept. 22, 2005, 15:19 EST) ("The bankruptcy bill was written by the credit industry lobbyists to help the credit industry . . ."). Of course, one cannot entirely ignore public choice considerations if one wishes to advance a policy proposal. Consider, then, that while the credit card industry is comfortably positioned in Washington, D.C., it might be that the post-Enron fallout on the corporate world will have a spillover effect even into this well-entrenched constituency. Note that the E.U. Consumer Credit Directive sprung out of disenchantment with corporate culture. See Ramsay, *supra* note 80. Consider also that bank regulators in the United States have increased the minimum repayment amounts despite credit card company grumblings. See Press Release, Federal Reserve Board, FFIEC Agencies Issue Guidance on Credit Card Account Management and Loss Allowance Practices (Jan. 8, 2003), available at <http://www.federalreserve.gov/boarddocs/press/bcreg/2003/20030108> [hereinafter Press Release, Federal Reserve Board, FFIEC]; Press Release, Federal Reserve Board, Credit Card Lending: Account Management and Loss Allowance Guidance (Jan. 8, 2003), available at <http://www.federalreserve.gov/boarddocs/press/bcreg/2003/20030108/>. Thus, the credit lobby star may finally be starting to fade. Indeed, while the bank lobby in England has tried to push back the proposed E.U. Consumer Credit Directive, a backlash against the Directive is building, as many commentators have found it, upon further reflection, too lenient. See Croft, *supra* note 80. Thus, it is far from clear that even hard-blowing political winds cannot change. The most interesting public choice angle, especially in the United States, is the role that religious leaders might take were they ever to turn their attention seriously to bankruptcy. For example, in the United Kingdom, far from intoning the virtues of honoring obligations and the morality of promise-keeping, the Bishop of Worcester was one of the most outspoken advocates for lender liability, raising basic issues of justice and concluding that "the people who need to be addressed about debt are the creditors, not principally the debtors. I say that partly out of a kind of slightly fundamentalist biblical orientation." See GRIFFITHS COMM'N, *supra* note 23, at 23; see also *Proverbs* 22:7 ("[T]he borrower is the slave of the lender.").

172. To be sure, there are others. From a doctrinal perspective of tort law, the harm here—financial ruin—is not the sort of physical harm at the core of fault-based tort; it is either emotional or economic harm, neither of which is a paradigmatic interest protected by negligence. It seems to me, as not a scholar of tort, that one of the main reasons the imposition of emotional harm is harder to justify than the infliction of physical harm emanates from second-order concerns of administrability. As such, I worry less about this proposal's necessary innovations to the positive law of tort. If pushed to shoehorn this proposal into an existing exception, I might analogize (admittedly not without stretching) the unintelligible credit contract to inaccurate information provided by an accountant who knows others rely upon the accuracy of his data in avoiding financial harm. But because the conduct of the lender is intentional (or at least reckless), I ought to be accorded some latitude in expanding the scope of cognizable harm. See Goldberg, *supra* note 140, at 533–34. Interestingly, the doctrinal avenue that would appear most fruitful for this proposal, regarding liability for foreseeably increasing the plaintiff's risk of harming himself, is one, disappointingly, U.S. courts thus far "have rejected." Goldberg & Zipursky, *supra* note 164, at 682.

sometimes there are other sources of blame: several reckless lenders together may collectively contribute to the debtor's problem, purely exogenous sources of financial distress may present themselves, and, of course, the borrower herself may play an important role.<sup>173</sup> Whether these are considered blended causes for financial default or joint fault is to some extent a semantic issue of what is (again, at least in this specific context) at its roots an attribution problem.<sup>174</sup>

The simple causal case of reckless lending involves an innocent borrower and one creditor with a grossly excessive loan, such as perhaps lending \$514 to someone on \$214 of monthly welfare income to buy a stereo.<sup>175</sup> It does not strain the imagination to say that regardless of the debtor's knowledge, the lender knew, or was reckless to the fact, that the debtor could not afford to take out this loan and that default was not only a foreseeable risk but a reasonably expected result of the debt.<sup>176</sup> The debtor's role in perhaps assuming a risk, or in contributing to the cause of the default by requesting the loan in the first place, may well be relevant (and will be discussed below in exploring contributory or comparative negligence), but that is a separate matter from the foreseeable consequences of the lender's conduct.<sup>177</sup> The lender caused the harm.

Note that any threshold suggestion that the default (or the decision to enter the credit contract) is the debtor's and not the lender's "conduct" should be dispatched. Holding *A* liable as the cause of *B*'s purported conduct is not problematic. This is so even for conduct that requires *B*'s participation. For example, as innkeepers will attest, it is not just the patron (*B*) who drives drunk who causes an accident but sometimes also the bartender (*A*) who saw him drive in and who holds the

173. Professor Long colorfully analogizes financial default to a car accident. See Long, *supra* note 73, at 242–43.

174. An interesting exploration of this sort of problem occurs in Kyle Logue & Ronen Avraham, *Redistributing Optimally: Of Tax Rules, Legal Rules, and Insurance*, 56 TAX L. REV., 157, 209–21 (2003) (examining redistributive principles from first the "simple" case of brute luck—purely genetically determined disease—to the harder case of multifactorial diseases whose epidemiology depends in part upon lifestyle choices).

175. See, e.g., *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965). Note that the ultimate holding of unconscionability in the *Williams* appeal drew on the contract's cross-collateralization clause. By contrast, the lower court opinion went into the patent inability of the consumer to service the debt. See Eben Colby, Note, *What Did the Doctrine of Unconscionability Do to the Walker-Thomas Furniture Company?*, 34 CONN. L. REV. 625, 637–38 (2002); see also *Discover Bank v. Owens*, 822 N.E.2d 869, 873 (Ohio Mun. Ct. 2004) (voiding credit card contract and exonerating bank for lending to unemployed debtor but "not even minimally pay[ing] attention to [his] circumstances"). A thorough analysis of the unconscionability doctrine's application to consumer credit cases can be found in Steven W. Bender, *Rate Regulation at the Crossroads of Usury and Unconscionability: The Case for Regulating Abusive Commercial and Consumer Credit Interest Rates Under the Unconscionability Standard*, 31 HOUS. L. REV. 721 (1994).

176. For a recent possible example of this, consider Al Lewis, *Dawdling Banks Cost Homeowners*, DENV. POST, July 23, 2006, at K1 (reporting story of mortgagee bank responding to defaulting debtor's request to sell home and presentation of willing bidders by refinancing the mortgage with an interest-only loan, which ultimately increased debtor's obligation to bank as home value continued to decline).

177. See RESTATEMENT (SECOND) OF TORTS § 496A (1977) (assumption of risk); *id.* § 467.

power of the tap.<sup>178</sup> Society feels comfortable imposing liability on these innkeepers to turn off the taps—notwithstanding their self-interested, profit-maximizing stake in selling more beer—and considers them causal agents in any subsequent accident involving *C* (or even just involving *B* alone).<sup>179</sup> Society does so, even though it dislikes drunk drivers much more than bartenders, because both actors contribute in their own ways to an ultimate drunk driving accident.<sup>180</sup>

Thus, placing some responsibility on the lender as a causal actor, at least in the simple case of an isolated and excessive loan, is straightforward. What becomes more challenging is the issue of blended cause (or joint fault), first with regard to the debtor, who may bear nontrivial blame in some if not many cases, and then with regard to external forces, which empirical studies suggest are common (the unexpected illness, the lost job, and so forth).<sup>181</sup>

How to deal with the debtor depends in part upon one's intuitions regarding the degree to which the debtor can prevent the underlying harm from occurring. Law and economics scholars posit that under certain assumptions regarding similarly situated actors with comparable control over care levels and evidentiary uncertainty, an efficient liability rule in tort is one of comparative negligence.<sup>182</sup> (Such a rule is also adaptable to contractual relief as well.)<sup>183</sup> While a comparative negligence rule diminishes the recovery of the debtor from a strict negligence rule, it imposes optimal deterrent incentives on the lender and borrower alike in the face of uncertainty. Accordingly, if one assumes that, notwithstanding the debtor's cognitive impediments that allow him to fall into the sweatbox in the first place, he can nevertheless play an impor-

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178. For a general discussion of dram shop liability, see 2 DAN B. DOBBS, *THE LAW OF TORTS* § 332 (2000 & Supp. 2005). Briefly, the common law in the 1960s began to recognize liability of tavern owners to the victims of intoxicated patrons, as well as in some cases to the patrons themselves, recognizing the inherently dangerous nature of the alcohol and the superior accident-preventing position of the tavern owner. Recent statutory codifications and reforms have focused on circumscribing the scope of dram shop liability (such as, for example, by insulating social hosts from liability, or ascribing liability only in cases involving obviously intoxicated patrons). See *id.*; see also *Burkhart v. Harrod*, 755 P.2d 759, 763 (Wash. 1988) (noting that Washington had enacted a law that provided a complete defense in tort actions involving intoxication where “the person injured or killed was under the influence of intoxicating liquor or any drug at the time of the occurrence causing the injury or death and that such condition was a proximate cause of the injury or death and the trier of fact finds such person to have been more than fifty percent at fault.” (quoting WASH. REV. CODE § 5.40.060)).

179. See DOBBS, *supra* note 178, § 332.

180. The social host generally escapes this liability, likely both because she lacks the comparative regulatory advantage of the tavern owner's cheaper cost-bearing and because society does not impose on her a private duty to the drunk driver's victim the way it feels comfortable doing with respect to a commercial proprietor of an arguably hazardous activity. See *Andres v. Alpha Kappa Lambda Fraternity*, 730 S.W.2d 547, 553 (Mo. 1987) (noting absence of social host's “pecuniary gain” and “expertise” in declining to impose duty of care).

181. See SULLIVAN ET AL., *supra* note 25.

182. See Robert D. Cooter & Thomas S. Ulen, *An Economic Case for Comparative Negligence*, 61 N.Y.U. L. REV. 1067 (1986) (refining “equivalence theorem” regarding irrelevance of standard of negligence to inducing optimal care in the face of full information).

183. See discussion *infra* Part VI.



tant role in minimizing the harmful consequences of financial default, then a comparative fault rule is a fruitful approach to pursue.<sup>184</sup>

Following the causation analysis of Professor Shavell, a similar rule of comparative apportionment can optimally deal with external diminutions with the fault of the lender, either because multiple lenders were jointly reckless in extending the debtor credit, or because exogenous forces beyond the lender's conduct helped contribute to the debtor's downfall.<sup>185</sup> Blended reckless-credit/exogenous-shock causes for bankruptcy could be dealt with through a similar comparative faultlike approach. Taking the cases at the ends of the spectrum first, therefore, it should be straightforward to say that when an overwhelmingly unserviceable debt is the only cause of bankruptcy, such as the stereo loan example above,<sup>186</sup> the reckless loan is presumed to be the predominate cause (reduced by whatever amount appropriate, if any, to account for the debtor's contribution). The other end of the spectrum would involve the borrower of a small sum who succumbed to a rare and debilitating career-ending injury that tragically required bankruptcy. To be sure, the small loan would be a but-for joint factual cause of the bankruptcy—without the debt, bankruptcy arguably could have been avoided—but it would seem a stretch to call it the proximate cause (or even joint proximate cause) of the filing.<sup>187</sup> Such a situation would be an inappropriate case for liability of the lender. The middle case, with substantial debtor fault (an example of which is explored below) would require split liability: for instance, a proportionate reduction in the amount of rescinded debt as a contract remedy or a proportionate reduction in a damage award as a tort remedy.

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184. If the likelihood of comparative borrower versus lender fault is biased (and known), then comparative negligence may lose its optimality. See SHAVELL, *supra* note 12, at 85; Cooter & Ulen, *supra* note 182, at 1100–01. Much of this article's foregoing analysis has focused on lender misconduct, but debtor misbehavior is explored below. Accordingly, in the absence of richer data, the middle ground of a comparative negligence baseline is attractive. Indeed, it is the possibility that debtors are not totally innocent—more precisely, that debtors can play a role in reducing the consequences of reckless credit—that suggests their “undeterrable” cognitive biases are not so pervasive as to preclude them from sharing in fault. Note also that the absence of such data counsel for a standard as opposed to a rule. See Kaplow, *supra* note 93, at 586–96.

185. SHAVELL, *supra* note 12, at 105–15.

186. Note that the stereo loan example above would likely satisfy adherents of a bright-line rule approach to defining the recklessness breach of duty (such as, for example, extending credit that could not be repaid with garnishable wages within sixty months), because \$218 of monthly income is well below the monthly federal wage garnishment limit of \$669.50. See 15 U.S.C. § 1673(a) (2000). Note too that inflation does not render these Williams-inspired numbers inapposite; in the District of Columbia, the Temporary Aid for Needy Families monthly payment for a family of three was increased only recently (in July 2006) from \$379 to \$407. See Press Release, Government of the District of Columbia, District to Increase TANF Cash Assistance Benefits for DC Residents (June 29, 2006), available at <http://www.dc.gov/news/release.asp?id=933>. Note also that Mrs. Williams already had an outstanding balance with Walker-Thomas Furniture in addition to the stereo loan, and so her lender knew her balance was even more than \$514.95. See *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 447 n.1 (D.C. Cir. 1965).

187. See DOBBS, *supra* note 178, § 53. Reanalyzing the same point from the duty perspective, it is difficult to say a “prudent” or “responsible” lender has a duty to predict rare disease.

Note that application of such a comparative approach in instances of partial lender wrongdoing and partial exogenous cause for financial distress (e.g., a reckless loan compounded by a debtor's heart attack) effectively imposes the cost of the exogenous loss on the debtor. That need not be the case. Consider that some systems place the cost of such loss on the lender. For example, the Finns have a doctrine of "*social force majeure*," where a valid defense to a consumer contract involves inability to pay for faultless reasons, such as job loss or illness, the same way regular *force majeure* typically excuses contractual performance for faultless reasons (other than God's).<sup>188</sup> If contractual enforcement is excused in a credit contract, the resulting loss allocation rule is to leave the risk of nonpayment on the creditor. Accordingly, one could have a special rule resolving the causation issue for reckless lending involving blended exogenous forces in bankruptcy by borrowing from the Finns' expansive understanding of *force majeure*—permit effective rescission of the contract, at least to the degree of the "faultless" debtor distress.<sup>189</sup> This would leave the lender to shoulder the costs of the exogenous source loss.<sup>190</sup> Such an approach, however, has fairness concerns of its own. As Professor Homer Kripke pointed out some time ago, if it is unfair to tax the debtor with responsibility for these unforeseen exogenous causes of financial default (assuming for discussion only that they are truly unforeseen),<sup>191</sup> then why is it any better to saddle his lender with them?<sup>192</sup> While the Finnish rule is interesting and perhaps worth future exploration, it suffices at this point to note that it would entail a substan-

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188. See THOMAS WILHELMSSON, CRITICAL STUDIES IN PRIVATE LAW 180-216 (1992) (advocating a system of debt forgiveness when difficulties in repayment are a consequence of the debtor's unemployment, illness, divorce, or other corresponding problems independent of himself, building upon the Nordic law principle of "*social force majeure*"). Apparently the German Federal Constitutional Court has "constitutionalized" this doctrine to a certain extent. See REIFNER ET AL., *supra* note 23, at 48-49 & n.35.

189. Excusing performance creates interesting issues of restitution. Cf. *Frostifresh Corp. v. Reynoso*, 281 N.Y.S.2d 964 (N.Y. Sup. Ct. 1967) (awarding cost, overhead, and "reasonable" profit to defendant who was found party to a rescinded unconscionable contract); see also Hersbergen, *supra* note 96, at 302-03 (arguing that imprudent secured creditor might be limited to repossession as remedy). *Quaere* whether this latter approach would create a strange moral hazard to consume.

190. Professor Craswell's analysis suggests that the cost will get shifted back to the borrower anyway even if placed on the lender. See Craswell, *supra* note 111. Note that such a rule might effect a redistribution—which may or may not be progressive—assuming that lending "bands" remain sticky. For example, one wonders how Congress would react to lenders calibrating price of credit to smoking status.

191. Logue & Avraham, *supra* note 174, consider cases in which it is debatable whether the sources of misfortune are within or beyond the actor's control. See generally Iain Ramsay & Toni Williams, *Inequality, Market Discrimination, and Credit Markets*, in CONSUMER LAW IN THE GLOBAL ECONOMY, *supra* note 74, at 233, 233-34 (Iain Ramsay ed., 1997) (noting that the decision to cast direct regulation as antithetical to, rather than constitutive of, "the market" simply depends on characterization and paradigm).

192. See Kripke, *supra* note 135, at 480. See Hersbergen, *supra* note 96, at 265, for a prediction that credit bureaus do in fact compile "emergency preparedness" information on debtors.

tial innovation to current legal practice to require a lender to bear the costs of losses that he did not himself cause.<sup>193</sup>

Finally, the desirability of some form of comparative fault (or comparative cause) rule will of course require doctrinal implementation. How will a court determine whether (and to what degree) a debtor's credit card loan was reckless in the face of competing possible causes of financial distress? This is a good question, but not without answer. Apart from using quantitative formulas based on financial ratios,<sup>194</sup> more traditional legal tools could be deployed. For example, courts could craft a temporal presumption (always of course mindful of hindsight bias) that the longer a loan was serviced without difficulty, the less likely it was to have been the cause of the debtor's default.<sup>195</sup> Indeed, bankruptcy law is replete with time periods that trigger presumptions and rules,<sup>196</sup> so such a temporal rule might actually be a familiar concept in the difficult, but not insurmountable, task of struggling with causation issues under a private liability regime.

In sum, joint causation (or joint fault) is likely to create serious challenges for the proposal of reckless lending liability, especially when complicating considerations of exogenous sources of financial default are included. But the foregoing discussion also put forward possible solutions, or at least the beginnings of possible solutions, to the tougher cases at the margin where causation is most likely to create mischief. Thus, the difficulties of causation are recognized, but by no means conceded as dealbreakers, to private relief for reckless credit.

### B. Costs

In addition to causation issues, the other major challenge to private liability will surely be cost. All things being equal, holding lenders liable (in either contract or tort) for palpably unserviceable loans will restrict the supply of consumer credit available, both directly for reckless credit (the type most likely to cause bankruptcy) and indirectly for all other forms of "good" credit as lenders incorporate a general risk premium for

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193. See SHAVELL, *supra* note 12, at 108, for consideration of theoretical potential for efficiency when injurers bear casually unrestricted liability, but further consideration that "crushing" liability would overly deter activity levels.

194. See, e.g., H.R. 3146, 105th Cong. (1998) (bankruptcy claim reduction for creditors whose debt caused debtor to exceed prescribed debt-to-income ratio).

195. Cf. *Van Orden v. Perry*, 125 S. Ct. 2854, 2869–70 (2005) (Breyer, J., concurring) (concluding that because religious monument went unchallenged for more than forty years, few must have viewed it as an official establishment of religion). Note that this temporal rule would in part turn the luxury goods presumption—where a short-lived unserviceable loan taken out close to bankruptcy is presumed to be the debtor's fault—on its head. See 11 U.S.C. § 523(a)(2)(C) (2000) (providing that debt from luxury goods purchased on or within sixty days of filing is nondischargeable).

196. See, e.g., 11 U.S.C. § 547 (2000) (providing that preferential transfers within ninety days of bankruptcy are generally voidable).

liability.<sup>197</sup> This intuition is supported to an extent by recent empirical data from the subprime mortgage market.<sup>198</sup> Price of all credit, good and bad, will presumably be adjusted at some level for the increased risk of liability.<sup>199</sup> Lawyers, especially tort lawyers, undoubtedly make any system more expensive, and there is no question that the fact-intensive investigation of individual lawsuits costs real money. These costs will be passed along to consumers whenever possible.<sup>200</sup> The consequence of this passed-along price increase (note that this mirrors a common argument against usury laws)<sup>201</sup> is that it will cause credit rationing and leave certain borrowers priced out of the consumer lending market altogether.

197. Nonoffenders face risk-bearing, agency costs, and overdeterrence, which result from risk aversion, legal ambiguity, and error costs. See Kraakman, *supra* note 147, at 878 n.59.

198. Interesting empirical evidence in the housing market, studying the effect of predatory lending laws on the restriction of capital supply and pricing, suggests that loan volumes do fall off under predatory lending laws (at least for “strict” laws, whereas the effect is more ambiguous for the “median” predatory lending law), as measured by applications for and originations of loans. See Ho & Pennington-Cross, *supra* note 44, at 19. There is also evidence of an interest rate premium charged in response to such laws. See *id.* at 19–20. This paper engages a broader literature of related studies, including those focusing on North Carolina, one of the pioneer states regulating subprime lenders. Strictly speaking, the supply of credit should be restricted if the market is competitive. If the market is not, then the result might be for lenders to charge lower, arguably less reckless, interest rates. See *id.* at 19.

199. There is a theoretical argument, borrowing from the ex ante/ex post cost-of-capital analyses in the corporate bankruptcy literature, that if increasing the harshness on lenders decreases the harshness on borrowers of bankruptcy’s ex post payoff state, then the ex ante demand effect might be increased appetite by borrowers—demand that might offset the restriction of supply and thus render ultimate price effect ambiguous. See Alan Schwartz, *A Normative Theory of Business Bankruptcy*, 91 VA. L. REV. 1199 *passim* (2005). This argument may not be supported by available evidence, at least in the subprime mortgage market. See *supra* note 198. The larger empirical question, which scholars are beginning to explore, involves the elasticity of the consumer credit market. For an illuminating recent discussion involving a direct-mail experiment with South African short-term unsecured consumer borrowers, see Dean Karlan & Jonathan Zinman, *Elasticities of Demand for Consumer Credit* (Yale Univ. Econ. Growth Ctr., Discussion Paper No. 926, 2005) (analyzing rate elasticity and maturity elasticity to demand).

200. See Craswell, *supra* note 111. For the seminal argument that seemingly “one-sided” contractual provisions actually help consumers by lowering total costs, see Richard A. Epstein, *Unconscionability: A Critical Reappraisal*, 18 J.L. & ECON. 293 (1975). The costs that cannot be passed on—such as the public burden of backlogging the bankruptcy courts with lender liability claims or defenses—will be borne by society as a whole. Then again, if the imposition of liability reduces the number of bankruptcies, society will have been spared some court-clogging expenses.

201. See, e.g., James M. Ackerman, *Interest Rates and the Law: A History of Usury*, 1981 ARIZ. ST. L.J. 61 *passim*. In Europe, where usury laws retain more bite than in a post-Marquette United States, see *Marquette Nat’l Bank of Minneapolis v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978), policy-makers continue to struggle with usury’s role in protecting (or excluding) consumers. The report *Consumer Overindebtedness and Consumer Law in the European Union* adopts a cautiously sanguine stance regarding usury law, which it is contended can increase “confidence and trust in such regulated consumer credit systems” and has “actually kept the exclusion rate quite low.” REIFNER ET AL., *supra* note 23, at 99–104, 228–29. By contrast, a special report commissioned by the U.K.’s Department of Trade and Industry presents more ominous data, including a possible disparate negative impact on low-income borrowers as well as a “non-cost” financial exclusion effect. See DEP’T OF TRADE & INDUS., *supra* note 49. It even suggests a correlation (for impaired borrowers) between usury ceilings and reported levels of illegal borrowing. This ongoing uncertainty over the impact of credit price regulation may in part account for the E.U. Consumer Credit Directive’s partial abandonment of harmonization in its most recent proposed draft.

This cost-based criticism should be dealt with by unpacking its components. First, there is the direct cost of legal liability. If some fraction of credit card loans are held reckless and trigger liability, then the cost of lending will rise. Second, if the cost of administering that liability involves the legal system, that involvement will raise an ancillary set of transaction costs. Third, there is the consequence that flows from these costs: if the costs go up, some debtors will be excluded from the market as a result.

Responding in turn, the first cost is intentional. The very problem sought to be redressed by this proposal is the burden of financial default inflicted both upon the debtor and the community by reckless consumer loans. Increased cost by way of internalization by lenders who do not even care whether an excessive loan destines a debtor for bankruptcy is welcome.<sup>202</sup> Indeed, for lenders of the traditional (nonsweatbox) business model, who are already conducting appropriate credit screening, compliance costs should be minimal,<sup>203</sup> so the increased costs will be felt mostly by the sweatbox lenders, which is just as it should be.<sup>204</sup>

Second, the transaction costs of resolving this liability through an adversarial legal system is arguably a heavy-handed solution.<sup>205</sup> But it comes after decades of frustration with more nimble but less efficacious efforts (e.g., disclosure-based regimes like the Truth in Lending Act) aimed at dealing with the worsening problem of overindebtedness and the emergence of a dysfunctional consumer lending business model.<sup>206</sup> Moreover, the much-maligned adversarial litigation system is also not without its advantages. In the world of debtor-creditor law, the power of judicially compelled information disclosure comes to mind.<sup>207</sup> Assuming,

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202. Whether these costs overshoot the mark and overdeter is a separate question. Perhaps a market this hot is likely to tolerate a good amount of cold water without fizzling out altogether.

203. To be sure, however, uncertainty at the margins within a tort-based system is likely to impose some overdeterrence costs.

204. The E.U. commentary addresses this issue with the following question and answer exchange:  
Will the proposal make consumer credit business more expensive for lenders?

No. On the contrary, the concept of responsible lending will force lenders to be careful. In the long run they will have to write-off fewer loans as bad debts. As the cost of writing off such uncollectable loans is included in the cost of credit, reducing the number of bad debts should result in cheaper loans.

Muench & Bunyan, *supra* note 94, at 2. To the extent that this compelled carefulness adds expense, those costs will be borne chiefly by lenders who are not already careful, while the rest of society enjoys the benefit of foregone default costs. Distributively, this may undo an existing cross-subsidy. *See infra* note 221.

205. *See, e.g.,* Bar-Gill, *supra* note 36, at 1379 (noting frequent preference for ex ante market regulation to ex post judicial intervention).

206. The Truth in Lending Act (TILA) is codified as amended at 15 U.S.C. §§ 1601–1693 (2000 & Supp. III 2003). TILA's existence does not appear to have stemmed the rise of consumer bankruptcy filings. This inefficacy casts doubt on the utility of "asymmetrically paternalistic" interventions, at least with respect to the phenomenon of reckless lending. *See* Colin Camerer et al., *Regulation for Conservatives: Behavioral Economics and the Case for "Asymmetric Paternalism,"* 151 U. PA. L. REV. 1211 (2003); Cass R. Sunstein & Richard H. Thaler, *Libertarian Paternalism is Not an Oxymoron*, 70 U. CHI. L. REV. 1159 (2003).

207. LoPucki, *supra* note 46, at 477–78.

as some do,<sup>208</sup> that there is a degree of debtor opportunism in the system and that not every asset finds its way onto schedules, perhaps the real discovery in an adversarial proceeding—not just the paper power of trustees to compel discovery in an administrative case—that will accompany reckless lending litigation will make debtors think twice about how coy to be in their bankruptcy pleadings. It would certainly chill reckless lending strike suits by debtors who want to go through bankruptcy with a low profile. Thus, a more litigious bankruptcy system may raise some costs, to be sure, but on the other hand it may yield a more transparent and efficient regime as a result. Only time will tell.<sup>209</sup>

In any event, even if liability does drive up costs, the real issue boils down to the third concern: credit rationing and the de-democratization of credit. Many scholars decry the role usury law might play in pricing certain high-risk borrowers out of the market.<sup>210</sup> Surely civil liability for reckless lending would raise similar concerns. Indeed, the European Union was clearly mindful of access-to-capital issues in its commentary to the proposed Consumer Credit Directive, asking “[w]ill the new directive make it more difficult for consumers to get credit?”<sup>211</sup> The E.U. responded to this worry with reflexive reassurance: “The directive is about protecting consumers against abuse, not about restricting the supply of credit. . . . We do not believe that higher standards of protection will reduce consumers’ access to credit.”<sup>212</sup> Nevertheless, a more honest and appropriate response is to acknowledge that although the Directive may price some borrowers out, such a result is acceptable.<sup>213</sup> Similarly, the

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208. See *id.* at 461–63.

209. This proposal is fully aware of the evils of the American tort system. See Kenneth G. Elzinga & William Breit, *THE ANTITRUST PENALTIES: A STUDY IN LAW AND ECONOMICS* 81–96 (1976) (examining the role of antitrust’s treble damage rule in attracting excessive litigation), discussed in Kraakman, *supra* note 147, at 884 n.79. It finds solace in several assumptions. First, as mentioned in the text, many debtors in bankruptcy like to keep a low profile and so are unlikely to be trawling for suits. Second, the lawsuits are unlikely to generate the eye-popping awards associated with horrible disfigurement physical injury cases and therefore are likely to be a low-margin business, probably handled by the debtor’s bankruptcy counsel rather than slick tort specialists. Finally, and perhaps most importantly, if only the baseline version of this proposal for the partial or complete contract defense (and not the full-blown tort action) is embraced, then the incentive for tort lawyers evaporates altogether. Accordingly, the Tort Lawyers from Hell may never even bother showing up. The real question to push on this point is: if the tort action is such small potatoes, and the award will go to the debtor’s estate in bankruptcy, will there be sufficient incentive to litigate? See REIFNER ET AL., *supra* note 23, at 134, on whether structural disempowerment may render consumer debtors the worst-positioned private litigants. Compare A. Mitchell Polinsky, *Private Versus Public Enforcement of Fines*, 9 J. LEG. STUD. 105, 107 (1980) (noting scale advantages for government regulation of conduct), with Hanson & Logue, *supra* note 31, at 1279 & n.476 (noting inadequate incentives of private parties to report misconduct to government regulators). My experience with bankruptcy law is somewhat more sanguine—debtors will almost always press viable defenses to claims, and so even if only the contract version of this proposal is adopted, there will still likely be sufficient debtor vigilance.

210. See, e.g., Ackerman, *supra* note 201, at 61–110.

211. See Muench & Bunyan, *supra* note 94, at 2.

212. *Id.*

213. For similar comfort, albeit from a different angle, with “antidemocratic” restriction on credit, see Eric A. Posner, *Contract Law in the Welfare State: A Defense of the Unconscionability Doctrine, Usury Laws, and Related Limitations on the Freedom to Contract*, 24 J. LEGAL STUD. 283, 285 (1995).

animating concern of this article is not that exuberant, or desperate, or irrational consumers often borrow socially harmful amounts of credit made easy by credit cards (although they probably do), but that they are led into doing so by an industry that arguably externalizes costs and certainly feeds upon shrouding and cognitive biases in pushing its product. This is the type of credit that ideally *should* be cut off.<sup>214</sup> Using reasoning that is equally applicable to reckless lending, Professor Craswell opines that this is the case with at least some types of product markets in reflecting on the costs of certain probuyer warranty terms:

To be sure, the possibility that some buyers might be priced out of the market is not necessarily bad, if buyers would be better off not buying the product in question. For example, if the product is an extremely risky one that would not be purchased by perfectly-informed buyers, and if a longer warranty would force the seller to increase the product's price to reflect those risks, the resulting reduction in sales might be defended on efficiency grounds once we adopt the values of a fully-informed buyer.<sup>215</sup>

This sanguinity with pricing out some consumers is made fully mindful of the “irreducible need” for credit by certain low-income borrowers as a demand function,<sup>216</sup> and the related concerns of substitution with other, arguably less savory, credit products in the event this market is reformed.<sup>217</sup> Again, the U.K.’s comprehensive approach illustrates why alarm over inelastic demand and substitution would be misplaced. In addition to clamping down on unfair credit contracts as a private law remedy (much in the spirit of this proposal), the United Kingdom is concomitantly injecting more public money into its “Social Fund,” which guarantees access to consumer loans for low-income Britons.<sup>218</sup> It is also

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Professor Posner argues that usury and restrictive contract rules serve a helpful role in counter-biasing the drift toward overly risky investment and borrowing patterns crafted by social welfare laws and safety nets. *Id.*

214. There is a sidebar cost issue regarding whether the legal protection should itself be waivable. It probably should not be. We have myriad compulsory legal rules, even in contract settings, premised upon the belief that if most people benefit from the rule, the transaction costs of opt-out are probably not worth the added utility for excusing the minority inefficiently (and unfairly) swept into the rule's scope. For example, one cannot self-insure for less than \$100,000 of deposit insurance coverage, even if one would like to negotiate with one's bank for a correspondingly higher rate of interest. This is so even for the very rich, who would prefer to do so and could arguably benefit from so doing. See 12 U.S.C. §§ 1811–1835 (2000); cf. Thomas Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1410 (1985) (endorsing nonwaivability of bankruptcy discharge due to consumer cognitive biases).

215. Craswell, *supra* note 108, at 24 (characterizing this result as a Shavellian level-of-activity effect). Elsewhere, Craswell repeats this point but qualifies that the warranty term itself must be efficient. See Craswell, *supra* note 111, at 396.

216. DEP'T OF TRADE & INDUS., *supra* note 49, at 10.

217. For a standard articulation of this conventional concern, see MANN, *supra* note 17, at 208–11.

218. For a discussion of this program, see Howells, *supra* note 74, at 278. The government has increased funding to the Social Fund (£90 million into Discretionary Social Fund by 2006) and its Financial Inclusion Fund (£120 million in 2006) in response to its *Tackling Over-indebtedness* action plan. See DEP'T OF TRADE & INDUS., *TACKLING OVER-INDEBTEDNESS 2006*, *supra* note 23, at 12, 48. A jaded economist might question why such public benefits take the form of subsidized loans as op-

beefing up a campaign to prosecute loan sharks.<sup>219</sup> Thus, dissuading profit-motivated lenders from originating loans that are likely to default need not be seen as a threat to the poor, especially if done in conjunction with parallel credit-accessibility reforms.<sup>220</sup> Indeed, the distributional consequences of such a regime may be affirmatively progressive.<sup>221</sup>

Therefore, in final analysis, the opened floodgates of costs (and related concerns of credit exclusion) with a private liability system may prove more imagined than real. More importantly, however, if one is both happy with increased costs borne by reckless lenders and comfortable with the continued availability of credit for all—and, thus, *really* only worried about the “nervousness” costs borne by responsible lenders, then one should take comfort, at least in an ideal world, that the reasonable man should not fear accountability for recklessness.<sup>222</sup>

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posed to outright grants. The answer likely lies in fostering a sense of social investment and financial rehabilitation.

219. See DEP'T OF TRADE & INDUS., TACKLING OVER-INDEBTEDNESS 2006, *supra* note 23, at 60.

220. Indeed, a sufficiently transparent credit product—even if high-interest-bearing—may well help low-income borrowers, given sufficient regulation and oversight. For example, in a forthcoming work, Professor Mann and his coauthor look at the previously maligned payday lending sector's potential to help provide access to capital for (at least banked) low-income borrowers. Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 UCLA L. REV. (forthcoming 2007). The Griffiths Commission's report also cautiously acknowledges the possibility for a well-functioning subprime debt market. See GRIFFITHS COMM'N, *supra* note 23, at 49–61. Other legal measures protecting access to credit for low-income debtors could include safe harbor rules for lenders who extend covenant-restricted loans for necessary consumer goods, building on contract law's “necessities” doctrine, see Larry A. DiMatteo, *Deconstructing the Myth of the “Infancy Law Doctrine”: From Incapacity to Accountability*, 21 OHIO N.U. L. REV. 481, 488–90 (1994), or even bankruptcy priority provisions that elevate necessities debts (as some countries already have), see REIFNER ET AL., *supra* note 23, at 185 (discussing Finland).

221. Craswell's analysis suggests that if the liability risk is accurately priced, it will be borne by borrowers as a class. Craswell, *supra* note 111. If this is so, then the rule may have intraclass redistribution effects. For example, if “regular” customers are low-margin accounts for credit card issuers and “sweatbox” customers are high-margin, then a level-of-activity reduction on sweatbox lending will cause lenders to raise their rates for ordinary customers to preserve profitability. While this may be unwelcome news to the median reader of this academic article, it will undo a likely regressive cross-subsidy. Interestingly, the GAO's report on credit cards suggests increasing reliance on penalty fees as a profit source for credit card lenders as interest revenues fall in a more competitive environment. See GOV'T ACCOUNTABILITY OFFICE, *supra* note 41, at 104. This cross-subsidy reversal would be an instance of using legal rules, rather than tax laws, as the redistributive mechanism. See Logue & Avraham, *supra* note 174. Note the progressivity of the redistribution depends (at least on conceptions of horizontal equity) on the degree to which one believes bankruptcy is within the debtor's control. See *id.* at 164 (differentiating Dworkinian ideas of endowment insensitivity and ambition sensitivity (citing Ronald Dworkin, *What Is Equality, Part II: Equality of Resources*, 10 PHIL. & PUB. AFF. 283, 293, 330 (1981))); see also Bar-Gill, *supra* note 36, at 1415.

222. Yes, of course the tort system is neither perfect nor costless. Even squeaky-clean lenders will probably have to price some sort of risk premium. See Kraakman, *supra* note 147. But there are responses to these concerns. For example, the Federal Reserve or Federal Trade Commission could establish safe harbor rules regarding loan terms for lenders seeking compliance assurance. See Republic of South Africa, National Credit Act 34 of 2005 s. 82(2)(a), available at <http://www.thedti.gov.za/ccrdlawreview/creditact2006.htm> (allowing for South African National Credit Regulator to “pre-approve” the “evaluative mechanisms” a lender has implemented to discharge its duty under section 81 to “prevent[] reckless credit”).



## V. FAIRNESS CONSIDERATIONS

As commercial law discussants, do we dare leave the comforting and tidy realm of costs and incentives to eat the peach of moral considerations and fairness?<sup>223</sup> Let us, perhaps foolishly, engage the following two fairness concerns that arise from the proposal of private liability for reckless lending.<sup>224</sup>

First, a theoretical objection that surely some must have is that holding the *lender* liable for the *debtor's* default seems to relieve the debtor of a substantial component of individual responsibility.<sup>225</sup> It brings to mind the infamous case of Dixie Lee Dorsey, in which the bankruptcy judge raked American Express over the coals for granting seven credit cards to an unemployed welfare recipient with two minor dependents whose sole source of income was "the munificent sum of \$480 per month from Social Security."<sup>226</sup> But the judge's exasperation equally fell (perhaps even harder) on Ms. Dorsey herself, who used that credit line to purchase a luxury holiday to Europe and exotic perfumes (in service of her desire to "smell good"), with dubious intention at best of repaying her debt.<sup>227</sup> Because the procedural posture of the case was whether, under the existing Code, Dorsey's debt should be nondischargeable,<sup>228</sup> the court ultimately held that it was and did not discharge it in bankruptcy. American Express got away scot-free because the court was forced into a binary determination on a dischargeability motion focused primarily on Dorsey's conduct.<sup>229</sup> Under the proposal of this arti-

223. Some gobble it down hungrily. See, e.g., Edith H. Jones & Todd J. Zywicki, *It's Time For Means-Testing*, 1999 B.Y.U.L. REV. 177, 181.

224. Part V addresses possible concerns from a fairness perspective. It does not trumpet the fairness benefits of the proposal. See *supra* note 223.

225. Consider the divergence of opinion reflected in the testimony to the Griffiths Commission. Compare GRIFFITHS COMM'N, *supra* note 23, at 7 (comments of Ed Mayo, Chief Executive of the National Consumer Council) ("Pushing credit was like pushing drugs, and the addiction was getting worse."), with *id.* at 8 (comments of Nick Pearson of adviceUK) ("To put it bluntly, there is a small but growing percentage of borrowers who use easy access to credit as a justification for what is little more than theft. Their decision to over-borrow is then rationalized by shifting the blame to the lenders, and their moral justification for their actions is some spurious notion of begin a victim or someone with an addiction.").

226. *Am. Express Travel Related Serv., Inc. v. Dorsey (In re Dorsey)*, 120 B.R. 592, 595 (Bankr. M.D. Fla. 1990).

227. See *id.* at 594. The debtor's repayment depended on the kindness of a possibly fictitious gentleman caller named "Jimmy Jones" with whom she was purportedly acquainted. *Id.*

228. See 11 U.S.C. § 523(a)(2)(C) (2000). Recently, courts have taken a more aggressive approach to creditors in such situations, restricting their access to plead nondischargeability. See, e.g., *In re Hernandez*, 208 B.R. 872, 879-80 (Bankr. W.D. Tex. 1997). For a good discussion of this trend, see Snow, *supra* note 45, and Richard H. Gibson, *Credit Card Dischargeability: Two Cheers for the Common Law and Some Modest Proposals for Legislative Reform*, 74 AM. BANKR. L.J. 129 (2000).

229. The *Dorsey* court expressed its disgust at American Express with the following outraged dictum:

It is absolutely appalling to this Court and it is difficult, if not impossible, to comprehend how a responsible business enterprise like American Express would grant seven credit cards to a widow with two minor children who had no gainful employment since 1978 and whose sole regular income was, and still is, the munificent sum of \$480 per month from Social Security.

*In re Dorsey*, 120 B.R. at 595.

cle, however, American Express's actions likely constituted reckless lending in the first place, and so a different result may have been reached.

Yet a troubling question arises from this example. Would fixing some form of liability on American Express in these circumstances for recklessly extended credit create a moral hazard: spend whatever you can get and then complain it was an improvident loan in the first place? In discussing this problem under the heading of "fairness considerations," note that the incentive problem is equally if not more worrisome from a moral perspective than from any potential inefficiency.<sup>230</sup> More broadly, would liability send a message that American Express, not Dorsey, is the primary moral actor in what is partially if not substantially Dorsey's misconduct?

Early commentators of a populist bent saw no fairness problem: "It does not seem too much to say that one who voluntarily extends credit by disregarding a known risk, or risks which could be discovered by a reasonable effort, should bear the loss when loss occurs."<sup>231</sup> Yet this answer seems too easy. The problem with blaming American Express entirely is that it removes responsibility from Dorsey.<sup>232</sup> American Express did not force Dorsey to go to France. She chose that herself, and surely there must be consequences for her actions. Nor did American Express entrap her (Bar-Gill might say seduce her).<sup>233</sup> True, it *enabled* her, in the full psychological sense of the word.<sup>234</sup> In fact, it affirmatively *enticed*

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230. See, e.g., Eric D. Beal, *Posner and Moral Hazard*, 7 CONN. INS. L.J. 81, 84-85 (2000) ("Economists' ideas about moral hazard focus on the same problem—that insurance may reduce care or induce fraud—but the 'moral' aspect of good and evil is absent."); William K. Black, *The Imperium Strikes Back: The Need To Teach Socioeconomics To Law Students*, 41 SAN DIEGO L. REV. 231, 251 n.40 (2004) (critiquing the economist point of view and contending that because economists tend to remove the "moral" aspect of moral hazard and recast it into option theory, they treat those who fail to engage in perverse behavior in the face of a moral hazard not as "good" or "moral," but rather stupid or irrational).

231. Countryman, *supra* note 13, at 23.

232. Thus, the United Kingdom, for example, has pushed back at the proposed E.U. Consumer Credit Directive's "responsible lending" duty by insisting on the equally relevant role of "responsible borrowing." Indeed, in new clause 19 to the Preamble, the 2005 revision adds expressly that "[c]onsumers should also act with prudence and respect their contractual obligations." Similarly, in the DTI's consultation solicitation on the revision, it noted approvingly that "[t]he modification of the duty to advise is helpful insofar as the onus is put firmly back on the consumer (who will be aware of his or her personal circumstances) to decide whether or not a product is suitable for his or her needs . . . ." DEP'T OF TRADE & INDUSTRY, *supra* note 80, at 26. As mentioned before, however, the DTI's positions have sometimes diverged. For instance, later in the same consultation paper, the DTI opposes strong harmonization in the Directive on the ground that it might restrict member states from taking *more* consumer-protective legal action, which might "encourage some lenders to adopt an attitude of minimal compliance." *Id.* at 27.

233. Bar-Gill actually does discuss some commentators who liken credit card marketing practices to entrapment. See Bar-Gill, *supra* note 36, at nn.227-30.

234. Popular modern self-help literature embraces this approach. See, e.g., PAUL RIVAS & E.A. TREMBLAY, IF YOU'RE FAT IT'S NOT YOUR FAULT (1995).

her.<sup>235</sup> But most would argue that Dorsey nevertheless possesses at least some degree of free will. Accordingly, for the same reason a comparative negligence rule can offer salutary incentives for both parties to optimize their levels of care, comparative negligence (or comparative contractual rescission) might offer relief from the fairness concerns animated by polar outcomes in cases such as *Dorsey* when there is clear joint malfeasance.<sup>236</sup> Apportioning the blame is thus not only efficient, but a way to make sure neither party gets off the hook when the other party looks worse. It helps the debtor does not succumb to any perverse moral temptations just because his lender made a reckless loan.

A second fairness concern (at least for some) with a proposal for creditor liability for the debtor's default stems from its inherent paternalism. The concern is not the potential for the debtor to abdicate her responsibilities but for the debtor to have her autonomy infringed. Yet again, the related concept of usury laws invokes a similar critique: by forbidding competent adults to enter into certain voluntary lending arrangements, we deny their dignity as fully functioning members of society to control their affairs through private lawmaking.<sup>237</sup> Indeed, the suggestion earlier of a necessities exception explicitly underscores the infantilizing nature of this treatment.<sup>238</sup> As the E.U. Directive commentary worries: "Does the concept of 'responsible lending' take away responsibility from consumers? Is there a danger that it treats them as minors and not as grown-ups who should be allowed to decide on their own?"<sup>239</sup> The answer to this concern is to hold one's head high and say that, as with seat belt laws, some paternalism is good paternalism.<sup>240</sup> This response may be simple, but it is not glib. It merely recognizes that, at some level, inclination or disinclination toward paternalism may reduce to certain moral axioms. This proposal *is* somewhat paternalistic; those with strong philosophical objections to state interference in contract law may therefore reject it out of hand. The only way to win them over, perhaps, is to point out that if what they begrudge is state interference with voluntary private conduct, a substantial cloud hangs over the purported

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235. Indeed, Dorsey's excursion was under a program American Express itself promoted called "Travel & Sign." *Am. Express Travel Related Serv., Inc. v. Dorsey* (*In re Dorsey*), 120 B.R. 592, 594 (Bankr. M.D. Fla. 1990).

236. Cooter & Ulen, *supra* note 182, at 1095–1100, offers a brief fairness defense of comparative negligence.

237. See Shiffrin, *supra* note 106, at 220 (discussing concern that paternalistic legal interventions accord "insufficient respect for the underlying valuable capacities, powers, and entitlements of the autonomous agent").

238. See *supra* note 222.

239. Muench & Bunyan, *supra* note 94, at 4.

240. For seminal treatment of contractual paternalism, see Duncan Kennedy, *Distributive Justice and Paternalist Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power*, 41 MD. L. REV. 563 (1982), and Anthony T. Kronman, *Paternalism and the Law of Contracts*, 92 YALE L.J. 763 (1983). For more recent treatment, see Sunstein & Thaler, *supra* note 206, at 1159 (advocating judicious use of default provisions and opt-out rules "to steer people's choices in welfare-promoting directions without eliminating freedom of choice").

voluntariness of reckless lending. If the premise of a cognitive bias is that a consumer, due to underestimation or myopia or some other psychological impediment, is unable to say what she truly wants in terms of credit, then the state's putting certain items, like unaffordable credit, off limits should be acceptable.<sup>241</sup>

To close this foray into fairness, it is worth a quick mention of personal responsibility. Much hand wringing occurred in Congress regarding the death of personal responsibility that practically made bankruptcy reform a moral imperative.<sup>242</sup> But, unlike in Europe, this call was a one-sided summons; there was no concomitant call for personal responsibility of lenders.<sup>243</sup> Corporations can have personal responsibility, or irresponsibility, too, as recent high-profile corporate scandals have made us painfully aware. A corporation can act only through living, breathing human beings.<sup>244</sup> Surely in a post-Enron world we should be placing more, not less scrutiny, on the conduct of institutional commercial actors.<sup>245</sup> Thus,

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241. Note that Kennedy, *supra* note 240, would chafe at my desire to shoehorn the paternalism into a cognitive defect and claim that I am hiding my true belief that such transactions are just normatively bad for debtors and hence, out of love for debtors, I am protecting them from bad decisions under free choice. I respond only by observing that allegations of Freudian denial are generally unfalsifiable.

242. See H.R. REP. NO. 107-3, at 6 (1999) ("Bankruptcy is a moral as well as an economic act. There is a conscious decision not to keep one's promises. It is a decision not to reciprocate a benefit received, a good deed done on the promise that you will reciprocate. Promise-keeping and reciprocity are the foundation of an economy and healthy civil society." (quoting *Bankruptcy Reform Joint Hearings Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary and the Subcomm. on Admin. Oversight and the Courts of the S. Comm. on the Judiciary*, 106th Cong. 98 (1999) (statement of Todd Zywicki, Professor, George Mason University School of Law))); see also 146 CONG. REC. S50 (daily ed. Jan. 26, 2000) (statement of Sen. Hatch) ("Not long ago in our Nation's past, there was an expectation that people should repay what they have borrowed. Hand in hand with this expectation was a stigma that attached to those who filed bankruptcy . . . . Our current system, I am sorry to say, allows some people who are able to repay their debts to avoid doing so.").

243. For moral reflections on the fairness position of creditors in England, see the Bishop of Worcester's comments, *supra* note 171. In the United States, there actually were some who called for creditor responsibility, but their concerns were largely ignored. See, e.g., 151 CONG. REC. E754 (daily ed. Apr. 25, 2005) (statement of Rep. Betty McCollum) ("[T]he bill completely fails to address consumer abuses by the credit card industry. Instead, this bill rewards irresponsible credit card companies who deceive consumers and target vulnerable families with questionable business practices and reckless lending."). For the cold shoulder accorded academics' suggestions for moving beyond debtor-focused legislation, consider the inefficacy of Professors Ziegel's and Ramsay's efforts in the recent Canadian insolvency reforms. Professor Ziegel's submission to the Personal Insolvency Task Force was completely ignored as apparently beyond the scope of the Task Force's ultimate mandate, and was received, according to Professor Ziegel, with "deadly silence" upon submission. See PERSONAL INSOLVENCY TASK FORCE, FINAL REPORT (2002), available at [http://strategis.ic.gc.ca/epic/internet/inbsf-osb.nsf/vwapj/pitf.pdf/\\$FILE/pitf.pdf](http://strategis.ic.gc.ca/epic/internet/inbsf-osb.nsf/vwapj/pitf.pdf/$FILE/pitf.pdf); see also Jacob S. Ziegel, The Credit Industries' Contribution to the High Incidence of Consumer Bankruptcies in Canada: A Discussion Document (May 26, 2002) (on file with author). The striking difference in approaches between the Europeans and the Americans in confronting consumer debt problems (the former see a communal problem of overindebtedness and the latter see an individual decay of personal responsibility) is well discussed by Professor Ramsay. See generally Ramsay, *supra* note 80.

244. See, e.g., Steven P. Croley, *Vicarious Liability in Tort: On the Sources and Limits of Employee Reasonableness*, 69 S. CAL. L. REV. 1705 (1996). Kraakman, *supra* note 147, examines the benefits of corporate liability versus individual liability in exploring this difference in actors.

245. Cf. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified as amended in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

it is worth reflecting yet again on the underlying link to the contract doctrine of unconscionability inherent in this proposal. There is something perverse about situating complete responsibility on the parties whose lives have been ruined by general financial default through their contractual obligations to others who should have never permitted a relationship to develop in the first place. A harm is inflicted by those commercial parties on the (albeit flawed) debtors. A private harm is suffered by these debtors that requires private compensation by, or at least relief from, the party who is responsible. Wholly apart from the ills visited on third parties, this conduct is just wrong. “[I]s it not well that somewhere in the system sits a man or woman empowered by the system to say, ‘It is not right that you have your bargain off your brother, and so you shall not?’”<sup>246</sup>

## VI. LINGERING QUESTIONS

At least three questions linger regarding the wisdom of allowing private relief against creditors for the reckless extension of bankruptcy-proliferating credit. Their discussion has been deferred until the preceding considerations, pro and con, were put on the table.

The first overarching question is what the magnitude of the private law remedy should be. Throughout this article, the analysis has referred to “private liability” and suggested that the presumptive remedy would be a contractual defense to a collection lawsuit, but it also entertained the possibility of a full-blown cause of action in tort. Part of this non-committal on remedy was because the difference—at least in this context—primarily boils down to the magnitude of the available relief.<sup>247</sup> The basis for government intervention (cognitive deficiencies of borrowers, sweatbox business model of lenders) was the primary inquiry, and it suggested a fruitful place for privately initiated, ex post incentive-based regulation. The question of the magnitude of that intervention is an ancillary inquiry. But readers who have come this far are owed at least some consideration of which is the preferable remedy to operationalize private creditor liability for reckless lending.

As a preliminary matter, while it is true that the main difference between a contract defense and a tort cause is the magnitude of potential victim relief, one important difference regards the negative externalities of financial default. As discussed above, there is an intuitive case for bankruptcy filings inflicting negative externalities beyond the specific debtor and his defaulted creditor.<sup>248</sup> Yet there is nothing approaching empirical certitude on the scope and magnitude of these (possible or

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246. Irving Younger, *A Judge's View of Unconscionability*, 5 UCC L.J. 348, 352 (1973).

247. Indeed, the proximity of this proposed liability to the contract-tort frontier of the legal landscape has already been discussed above. See *supra* text accompanying notes 105–08.

248. See *supra* notes 26–35 and accompanying text.

probable, depending on one's intuitions) externalities. This uncertainty is relevant for choosing between a contract or tort remedy because if there are serious externality concerns, then a full tort remedy may be required to internalize all the costs of the reckless lending transactions. While a contract defense will have an activity-level-reducing effect, it will necessarily be an incomplete form of internalization because it will not, by definition, incorporate the effects on third parties. Accordingly, if externalities from reckless lending turn out to be a serious concern in the consumer debt market, then the appropriate implementation of a private, victim-initiated, ex post incentive-based regime may have to be through an affirmative cause of action, in tort, to force full internalization. Doctrinally, this action could be modeled after the French tort of "improper support," with a similar metric of damages.<sup>249</sup>

By contrast, if the case for externalities is an uneasy one, or at the very least an unproven one, then a remedy should not be selected based on a preoccupation with internalizing costs. Indeed, the problem of the sweatbox lending model that exploits the cognitive defects of certain borrowers is an independent ground for policy intervention wholly apart from any trouble with externalities. Moreover, it is not one that intrinsically requires a tort remedy; it could plausibly be corrected with more cautious relief through contract. For example, such an approach could follow the path of the new South African National Credit Act, or the judicial review of unfair credit transactions along the lines of the new U.K. bill.<sup>250</sup> Building on the relationship to the unconscionability doctrine, a contractual solution could hold the agreement unenforceable when a deficient account is sued for collection but not accord the debtor any affirmative right to proceed with his own lawsuit for damages.<sup>251</sup>

The contract approach has the advantage of conservatism in an uncertain environment; it is a less invasive policy tool. As such, it enjoys the presumption of being the preferred remedy in an uncharted domain. It does, however, have two concerns that may give a policymaker pause. The first is administrative. As a remedy, contractual rescission—simply declaring a contract "unenforceable"—sounds straightforward, but it is in fact only so prior to performance.<sup>252</sup> Rescinding a contract after the

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249. See Omar, *French Insolvency Law*, *supra* note 77 (explaining French tort damages rule as "the difference between the results of the insolvency proceedings in the instant case and what they would have been if the bank had not contributed to artificially prolong the life of the company").

250. See discussion *supra* notes 76, 80.

251. Note that in Craswell's taxonomy unconscionability can be divided into property rule cases (accord victim a veto right over enforcement of contract) and liability rule cases (accord victim no veto over enforcement, but only permit enforcement if flawed consent was beyond injurer's control and impugned term is substantively reasonable). See Craswell, *supra* note 108. Because the deception in these cases is creditor-initiated, reckless lending would fall into the property rule cases, perhaps analogous to the incapacity doctrines, although Craswell offers pragmatic reasons why a liability rule might be preferable. See *id.* at 63.

252. Cf. Craswell, *supra* note 108 (designing property rule unconscionability example to occur prior to performance).

train has left the station creates a host of remedial headaches.<sup>253</sup> Indeed, resolution of contract cases involving unconscionability of credit terms has been a haphazard affair at best.<sup>254</sup> Some of these cases struggle to accord the unconscionable lender a "reasonable" return on the credit to assure a fair result;<sup>255</sup> others just throw up their hands at the moment when litigation is brought, apparently deciding the equitable payoff in restitution is not worth the administrative difficulty.<sup>256</sup>

Given that a rough tradeoff between equity (for the benefit of the unconscionable actor) and administrability already appears to guide the fine-tuning of an unconscionability remedy, perhaps the answer to this concern is to note that this proposed private law defense of reckless lending, as discussed above, already has a comparative fault dimension incorporated in calculating the relief available. While the adjustment rule of comparative fault is traditionally thought of as a tort doctrine, there is no reason why it cannot apply to a contract as well. That is, if the debtor is found to be equally to blame for the financial default as his reckless lender, then the contract could be only 50% rescinded, meaning that the creditor would only have half of his claim reduced.<sup>257</sup> Such an approach has been proposed in other contractual contexts in the past and is being applied to new ones at present.<sup>258</sup> True, the adjustment may not necessarily match the degree of performance by the creditor,<sup>259</sup> but it minimizes the unfairness concern at the outset by reducing the scope of the problem: only part, not all, of the contract will be unenforced. Moreover, any potential divergence from unconscionability relief is likely warranted because reckless lending is similar—but not identical—to unconscionability. The key difference is with the counterparty's participation.

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253. See RESTATEMENT (SECOND) OF CONTRACTS § 208 cmt. g (1981) ("[U]nless the parties can be restored to their pre-contract positions, the offending party will ordinarily be awarded at least the reasonable value of performance rendered by him.").

254. Compare, e.g., *Jones v. Star Credit Corp.*, 298 N.Y.S.2d 264 (N.Y. Sup. Ct. 1969) (barring merchant from further recovery than already-paid \$619.88 on freezer sold for \$1234.80 with retail value of \$300), with *Frostifresh Corp. v. Reynoso*, 281 N.Y.S.2d 964 (N.Y. App. Term 1967) (reducing freezer merchant's contract entitlement to freezer cost plus "reasonable profit"), and *Lefkowitz v. ITM, Inc.*, 275 N.Y.S.2d 303 (N.Y. Sup. Ct. 1966) (awarding prospective injunctive relief). For even more cases, see Craig Horowitz, *Reviving the Law of Substantive Unconscionability: Applying the Implied Covenant of Good Faith and Fair Dealing to Excessively Priced Consumer Credit Contracts*, 33 UCLA L. REV. 940 (1986).

255. See, e.g., *Carboni v. Arrospide*, 2 Cal. Rptr. 2d 845, 847 (Cal. Ct. App. 1991) (unconscionable interest rate of 200% reduced to "reasonable" level of 24%); *Frostifresh*, 281 N.Y.S.2d 964.

256. See, e.g., *Williams v. E.F. Hutton Mortgage Corp.*, 555 So. 2d 158, 162 (Ala. 1989) (full performance of contract by buyer precluded his recovery of putatively unconscionable interest); *Jones*, 298 N.Y.S.2d 264.

257. This abatement rule is why unconscionability is an apt but imperfect analogue to reckless lending; there does not appear to be a doctrine of semiunconscionability.

258. Professor LoPucki once recommended an approach to bankruptcy varying the discharge based on the culpability of the debtor. See LoPucki, *supra* note 46. This is also the approach proposed by Professors Ben-Shahar and Gulati in their analysis of the problem of "odious" sovereign debt. Omri Ben-Shahar & Mitu Gulati, *Odious Debt: A Framework for an Optimal Liability Regime* (unpublished manuscript on file with author).

259. Cf. SHAVELL, *supra* note 12 (suggesting overdeterrence potential for noncausal liability).

She is not the innocent victim of the paradigmatic (or at least romanticized) unconscionability case; she is more likely, at least if she is like Dorsey, a joint wrongdoer.<sup>260</sup>

The second potential problem with a contractual approach is that a “mere” contract remedy may underdeter lenders. To understand the risk of underdeterrence posed by contractual relief, recall that the sweatbox model predicts that lenders have *already* priced in the risk of writing off the outstanding loan balance in bankruptcy (i.e., being barred from collecting on the contract). Yet they still profit. Accordingly, threatening the lender with forfeiture of the outstanding balance of her contract seems at first blush to be a hollow repetition of something she already countenances.<sup>261</sup>

It is possible, however, that a contractual remedy’s potential underdeterrence can be corrected. First, while the contract proposal is for a collection bar outside of bankruptcy, it comes with a concomitant disallowance rule (or abatement rule, if adopting a comparative fault-inspired approach) inside bankruptcy. That could well effect a meaningful change to existing lending practice, especially if the sweatbox margins are sensitive,<sup>262</sup> and even more especially under a new bankruptcy regime designed to increase the proportion of chapter 13s.<sup>263</sup> Second, fines could always be used to supplement contractual relief.<sup>264</sup> Conceivably, even punitive damages could be awarded.<sup>265</sup> Third, earlier relief could be made available to debtors through use of declaratory judgments. Such legal preemption could undermine a key component of the sweatbox model. Recall the sweatbox requires a minimum period of sweating to be viable. If bankruptcy is filed shortly after the credit is extended (or if other legal relief is secured), then the lender will not generate sufficient fees to have made the loan worthwhile. Accordingly, if debtors could rescind their contracts further up the timeline—as a declaration of rescission would permit—then a reduction or bar on principal recovery could work well as a deterrent. Finally, it may simply be that the sweatbox model is not as robust as Professor Mann intuitively feels (and intuitively is the best he

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260. One of course should not extrapolate from the salient and colorful *Dorsey* case. Indeed, I readily confess not to know the extent to which *Dorsey* is representative. But that candor simply supports my down-the-middle recommendation of a comparative fault-inspired approach. See Cooter & Ulen, *supra* note 182.

261. This assumes, under the strictest extrapolation of Mann’s model, that the lender anticipates writing off all reckless loans, which may not be a realistic assumption. See *infra* text accompanying notes 266–68.

262. See *infra* note 291.

263. Losing a claim in a chapter 13 is, by hypothesis of BAPCPA, worse than losing a claim in chapter 7 because the debtor is supposed to pay out more to his unsecured creditors under chapter 13. The fact that the vast majority of chapter 7 cases are no-asset cases mitigates, but does not eliminate, the smart of having a bankruptcy claim disallowed.

264. See Hanson & Logue, *supra* note 31, at 1279 n.476.

265. Professor Craswell makes a similar observation regarding how a penalty rule could respond to possible underdeterrence with a liability-based unconscionability rule. See Craswell, *supra* note 108, at 16–17.



can do with often inaccessible proprietary data).<sup>266</sup> For example, this article previously considered the charge-off rate for credit card debt in sharing Mann's conclusion that these lenders exhibit disregard for high-risk borrowers likely to default. But maybe lenders' seeming ambivalence toward the ultimate fate of their customers is limited: perhaps if every one of those cases defaulted it would be too much of a good thing and the practice would collapse. Similarly, it could be that the sweatbox business model incorporates nontrivial expected recovery through voluntary settlement, even for loans in default. Changing the legal entitlements to make collection on these debts more difficult would presumably change these settlement expectations. In summary, even under a sweatbox model that builds in partial or complete loss on the principal, it remains plausible that a mere contract remedy may not run the risk of underdeterrence.

Therefore, because of the uncertainty still swirling in this inchoate policy field, and because the risks of underdeterrence are likely overstated or remediable, the most conservative and hence desirable private law solution would be to adopt the one that minimizes the magnitude of the remedy and exposure of the lenders.<sup>267</sup> This would be the comparative fault-inspired approach of partial contractual relief: writing off the debt to the degree of the comparative recklessness of the lender. If the bankruptcy judge (the likely adjudicator where, as a practical matter, most of these disputes will play out) decides that the reckless lender was twice as much to blame as the borrower for the circumstances leading to the debtor's default, then the result should be a one-third reduction on the outstanding claim. As for the doctrinal question of how to determine that ratio of comparative fault, that is the sort of fact-sensitive equitable adjudication that bankruptcy judges do all the time.<sup>268</sup> In summary, given the uncertainty regarding such important matters as the scope of bankruptcy externalities and whether there is a bias toward lenders or borrowers as bearing primary responsibility for the consequences of reckless credit, the most prudent application of private liability against lenders at this time would be through a comparative fault-inspired rule of proportionate debt reduction relief from contract.

A second broad concern with private liability for reckless lending pertains to the macroeconomic effects of potentially restricting consumer credit. Again, earlier populist scholars delighted in reducing the outstanding amount of personal debt: "If such a[n improvident lending] standard imposes some brake on the credit boom, it would be a brake wisely applied in the interests of both the consumers and the extenders of

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266. The GAO's *Credit Cards* report politely makes this point too. GOV'T ACCOUNTABILITY OFFICE, *supra* note 41, at 82.

267. Recall that one consequence of overdeterrence of creditors is unnecessarily pricing some borrowers out of the credit market—a serious cost indeed.

268. Consider, as just one example, former 11 U.S.C. § 523(a)(15)(B) (2000) (deleted by BAPCPA).

credit.”<sup>269</sup> Yet the considerations may be more complex. This article has focused primarily on the bad side of consumer debt, likening it to a scourge such as smoking.<sup>270</sup> But the fact remains that, unlike smoking, and critically so, consumer credit has considerable positive benefits.<sup>271</sup> Consumer credit fuels domestic spending and the gross domestic product.<sup>272</sup> It has negative side effects when abused, of course, and those side effects do not appear fully internalized by those who inflict them. Yet on the whole, as we saw in President Bush’s admonition to go out and spend after September 11th for the sake of the economy,<sup>273</sup> consumer credit has some good. Thus, maybe consumer credit is more like the sin of fast food—good for many things like road trips but devastating if overused.<sup>274</sup> Indeed, one sees Congress taking a dim view to obese people suing McDonald’s notwithstanding the palpable adverse effects the obesity epidemic is inflicting on our society.<sup>275</sup> Clearly, deterrence through private liability is a touchy issue when it implicates mixed good-bad products like consumer credit (and the McGriddle®).<sup>276</sup> Accordingly, assuming for discussion that some broader cost-benefit analysis governs a

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269. Countryman, *supra* note 13, at 23.

270. See generally Robert F. Cochran, Jr., *From Cigarettes to Alcohol: The Next Step in Hedonic Product Liability?*, 27 PEPP. L. REV. 701 (2000). Following the smoking comparison, one of the English proposals is to include “health warnings” on credit card statements, analogous to those on cigarette packages, regarding the perils of, for instance, negative amortization. See *supra* notes 67, 166.

271. “The liberalisation of credit markets over recent decades is welcome: this has made access to consumer credit possible and has empowered a large proportion of our society. It is not a social evil.” GRIFFITHS COMM’N, *supra* note 23, at 23. On the heels of this certainly accurate recognition, however, the Commission went on to find that “[c]reating competitive markets will not in itself result in responsible borrowing and responsible lending” and that “[t]here is not a level playing field between borrowers and lenders. Consumers need greater protection.” *Id.*

272. See, e.g., Dean M. Maki, *The Growth of Consumer Credit and the Household Debt Service Burden*, in THE IMPACT OF PUBLIC POLICY ON CONSUMER CREDIT 43 (Thomas A. Durkin & Michael E. Staten eds., 2002); see also MANN, CHARGING AHEAD, *supra* note 17, at 44.

273. Press Release, President George W. Bush, President Discusses Economic Recovery in New York City (Oct. 21, 2001), <http://www.whitehouse.gov/news/releases/2001/10/20011003-4.html>.

274. For an analysis of the fast food industry, including its propensity to place franchises in areas with higher concentrations of poor people, see MORGAN SPURLOCK, DON’T EAT THIS BOOK: FAST FOOD AND THE SUPER SIZING OF AMERICA (2005). For more restrained treatment, see ERIC SCHLOSSER, FAST FOOD NATION: THE DARK SIDE OF THE ALL-AMERICAN MEAL (2002).

275. Bills that protect the food industry from lawsuits by obese consumers, called “cheeseburger bills,” have been passed in at least fourteen states. Editorial, *Don’t Blame the Burgers*, USA TODAY, Jan. 31, 2005, at 10A. A federal cheeseburger bill, the Personal Responsibility in Food Consumption Act of 2005, passed the House of Representatives last year. See H.R. 554, 109th Cong. (2005). A related bill was introduced in the Senate in 2005 by Senator Mitch McConnell. Commonsense Consumption Act of 2005, S. 908, 109th Cong. (2005).

276. Tort immunity for selling fast food may result from other factors, such as the effect of successful lobbyists or even a moral sense that fat people are more to blame, or less other-regarding, than their smoker counterparts. See Brooke Courtney, Note, *Is Obesity Really the Next Tobacco? Lessons Learned from Tobacco for Obesity Litigation*, 15 ANNALS HEALTH L. 61 (2006). And for edification, the McGriddle® is a breakfast sandwich in which the traditional Egg McMuffin®’s healthy collection of fried egg, fried Canadian bacon, processed cheese, and buttered English muffin is modified by replacing the English muffin (arguably the healthiest ingredient) with two English-muffin-sized buttered and maple syrup-infused miniature pancakes. As one bites into it, sometimes syrup can be heard (and felt) squishing out. The handbasket speeds along.

congressional policy quest for utility maximization,<sup>277</sup> one confronts a knotty empirical question: would the losses of a potential contraction of GDP through a liability-induced retrenchment of commercial credit be greater than the gains accrued by eliminating “avoidable” personal bankruptcies? The intuition underlying this analysis is that they probably would not, but the contrary position cannot be excluded. The current proposal can be defended, however, by noting that even if it is close to a social welfare wash, the distributional consequences make the losses of GDP contraction much more diffuse and bearable than the highly concentrated pain of personal bankruptcy.

The final overarching issue of the consumer credit problem returns to the demand side—the debtors. Perhaps rather than punishing debtors in bankruptcy, a better approach might be reeducation, along the lines of Congress’ introduction of compulsory credit counseling and debt management classes under the new law.<sup>278</sup> Some critics decry the costs and delays that these new procedural requirements have added to the Code,<sup>279</sup> but their thematic underpinning—that of reducing the demand side of the consumer credit problem—surely deserves some sympathy. Education would also make the exploitation inherent in the sweatbox model harder to pull off.<sup>280</sup> To be sure, recent psychological data suggest that there is a long way to go in changing consumer sentiments, but that does not mean reeducation is impossible.<sup>281</sup> The better placed critique of the Code’s new education provisions is that they take an *ex post* approach to education—after the debtor has wound up bankrupt—rather than an *ex ante* one such as the British curricular reforms. If Congress were serious about debtor education, perhaps consumer credit would even involve licensing or some similar *ex ante* requirement. The larger problem with reeducation is that it can take time, perhaps generations, to take effect. In any event, harnessing the profit motivation of professional lenders by the imposition of private liability might be a sound pro-

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277. Over the death cries of rights-based theorists.

278. See BAPCPA, Pub. L. No. 109-8, § 106, 119 Stat. 23, 37–38 (codified at 11 U.S.C. §§ 109(h), 521(b), 727(a)(ii)).

279. See, e.g., Henry J. Sommer, *Trying to Make Sense out of Nonsense: Representing Consumers Under the “Bankruptcy Abuse Prevention and Consumer Protection Act of 2005,”* 79 AM. BANKR. L.J. 191, 191–93 (2005) (predicting that the new means test, along with other provisions, will make it harder and more expensive for debtors to file).

280. Indeed, the U.K. initiatives have put great emphasis on education, including amending school curricula to address indebtedness issues, as well as community outreach programs. See DEP’T OF TRADE & INDUS., TACKLING OVER-INDEBTEDNESS 2006, *supra* note 23, at 50–52.

281. See Richard L. Wiener et al., *Psychology and BAPCPA: Enhanced Disclosure and Emotion*, 71 MO. L. REV. (forthcoming 2007). The report *Consumer Overindebtedness and Consumer Law in the European Union* provides a good discussion of the psychological role “reflection” plays in impulsive consumer borrowing. See REIFNER ET AL., *supra* note 23, 111–16. As for more subtle cultural shifts, see GRIFFITHS COMM’N, *supra* note 23, at 20 (“Credit has moved from being dangerous, to morally neutral, to being beneficial. . . . The term ‘credit’ is applied to what our grandparents called ‘debt.’” (citations omitted)).

posal on the supply side of reckless credit, but it is not intended to be exclusive of demand-focused reform.

## VII. CONCLUSION

This article has argued for the consideration of private liability against lenders who know, or are reckless to the likelihood, that the debtor has no realistic prospect of repaying his loan within a reasonable period of time.<sup>282</sup> Building somewhat on the doctrine of unconscionability, the most prudent implementation of this proposal would be a partial defense to contract collection proceedings (coupled with a claims disallowance rule in bankruptcy) that precludes recovery on the debt by the lender proportionately to the degree to which his reckless extension caused the debtor's ultimate financial default. An alternative rule to reduce administrability concerns (at the risk of raising moral hazard concerns) would be to implement it as a bright-line bar to all recovery under the contract.<sup>283</sup> The most aggressive implementation of the proposal would be to accord the debtor independent grounds to pursue a tort action against the lender for all consequential harm shown to be caused by the reckless loan (which itself could adopt a comparative fault apportionment rule to reduce damages as well). Although the bankruptcy system in some ways already functions as a bar against recovery through the discharge, express abatement of claims would make clear that the creditor would receive reduced distribution from whatever scraps remained in an asset case of liquidation in chapter 7 and would be eligible for only limited participation in a wage earner plan in chapter 13. Private relief therefore would be available both inside bankruptcy as a claims disallowance measure and outside bankruptcy as preemptive federal law.

This innovation in commercial law would deal with the rampant expansion of credit card debt that is facilitated by a destructive business model—debt that is now linked to the epidemic of consumer bankruptcies. While consumer credit enables a thriving domestic economy, it also leads to overindebted borrowers undergoing financial distress. This distress has economic, medical, and, indeed, moral consequences to the debtor and to others. In a sense, the proposal is for a return to the pre-sweatbox lending model of decades past (notwithstanding Countryman's concern that even that model was unacceptable), where lenders eschewed default in a more tightly regulated market.

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282. The weak-hearted will not like that some countries make this liability criminal. See Omar, *Reforms to Lender Liability in France*, *supra* note 77, at 280–81. This might be too much social condemnation even for me. (It would also forfeit the instrumental advantage of private attorneys general.)

283. See, e.g., Luize E. Zubrow, *Creditors with Unclean Hands at the Bar of the Bankruptcy Court: A Proposal for Legislative Reform*, 58 N.Y.U. L. REV. 1383, 1416–22 (1983) (advocating for only a defense and not an independent tort).

Congress has seen fit to swing sticks at debtors in order to diminish the number of consumer bankruptcies. This article suggests that those sticks might have been better swung at creditors. They are likely to be the most cost-effective parties to calibrate bankruptcy-causing consumer credit to an optimal level (if forced to internalize costs) and are certainly better equipped with the faculties and facilities to do so. The United States should join its international peers in recognizing that bankruptcy is not merely a character flaw of individual borrowers: it takes two to do the overindebtedness tango.<sup>284</sup> The operational difficulties of causation and the potential systemic difficulties of cost should give reflective pause but should not stand in the way.

Private liability has the advantage of recognizing a personal harm inflicted upon the debtor by the lender's conduct, whether it is through the fixing of responsibility in tort or through a pronouncement of the contract's quasi-unconscionability. Whether private liability is the superior approach from a pure policy perspective remains to be seen. To be sure, this article has discussed some of the perceived benefits of the proposal, but it does not seek to preclude consideration of other avenues, such as *ex ante* taxation. Indeed, recent public regulation from bank overseers on repayment terms for credit card accounts in the United States may already be cooling the sweatbox encouragingly.<sup>285</sup> If regulatory will does not stall, that might be a highly promising path. The E.U.'s Consumer Credit Directive is also a worthy response, albeit with ominously vague remedies, but it now faces an uncertain future due to infighting.<sup>286</sup> All these other possibilities and the general uncertainty of this area may well militate in favor of proceeding cautiously and with *ex post* remedies such as private liability rather than command-and-control or performance-based edicts.

This article began with an insistence that it was not animated by general debtor solicitude. That bears repeating. Indeed, a Canadian-style regime of shorter but compulsory chapter 13 wage earner plans

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284. See generally GRIFFITHS COMM'N, *supra* note 23; REIFNER ET AL., *supra* note 23; Omar, *Reforms to Lender Liability in France*, *supra* note 77, at 283–84 (explaining French law). As discussed above, in the United Kingdom, the 2006 Consumer Credit Act repealed and replaced the sections of the 1974 Consumer Credit Act that had allowed judicial review of “extortionate credit bargains.” See Consumer Credit Act, 2006, cs. 19–22 (Eng.) (revising the “extortionate credit” sections of the Consumer Credit Act, 1974, c. 39, § 140A (Eng.)). The new Act adopts a more expansive mandate to consider a wider array of factors in invalidating credit contracts, including the terms of the agreement and the relationship between creditor and debtor, expressly to capture irresponsible lending. *Id.* c. 19.

285. See Press Release, Federal Reserve Board, FFIEC, *supra* note 171.

286. See *Consumer Credit Directive*, *supra* note 61, at 28. Article 31 lists remedies that sound privately directed (e.g., the forfeiture of interest and the rescheduling of debtors' repayment terms), but it is unclear whether debtors themselves have standing to enforce these seemingly private remedies, although comparison to various European countries' commercial law regimes suggests that they would. The revision to this article in the second version of the proposal deletes these examples outright, further confusing this matter. Note, however, that the U.K.'s consumer credit bill clearly allows for private relief from “unfair” credit agreements, which may permit private enforcement of many of the bill's other provisions. See Consumer Credit Act, 2006, c. 19 (allowing relief upon application of a debtor to a court).

might be a welcome development as the ultimate debtor means testing.<sup>287</sup> The German and Austrian idea of tying the debtor's discharge to employment seeking is also interesting.<sup>288</sup> Thus, it is not friendliness toward debtors, but the imbalance and inefficiency of Congress' recent efforts with the bankruptcy laws that demand the seemingly prodebtor correction of lender liability.<sup>289</sup>

The article will now close with a glimmer of hope regarding Congress' willingness to target creditors. One of the less-discussed provisions of the new Code is § 502(k), which encourages voluntary write-down of claims by creditors.<sup>290</sup> It is narrowly drawn, of course, but its encouragement of consensual workouts—under the shadow of a forced haircut—suggests that Congress is not above squeezing creditors.<sup>291</sup>

The explosion of consumer credit card debt in this country is not just a problem of reckless borrowing; it is equally, if not more, one of reckless lending. Fixing liability on the party in the lending relationship best situated to ferret out these reckless loans that lead to bankruptcy may shock the system, but such a jolt may be just what the system needs.

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287. Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3 (Can.). An interesting recent proposal in this regard was Professors Braucher and Mooney's that debtors be tithed during bankruptcy a certain percentage of gross income so as to maximize incentives for expense reduction and income realization. See Jean Braucher & Charles W. Mooney, Jr., *Means Measurement Rather than Means Testing: Using the Tax System to Collect from Can-pay Consumer Debtors After Bankruptcy*, AM. BANKR. INST. J., Feb. 2003, at 6.

288. See REIFNER ET AL., *supra* note 23, at 189.

289. See GRIFFITHS COMM'N, *supra* note 23, at 23 (noting how current debt relief laws are skewed in creditors' favor).

290. BAPCPA, Pub. L. No. 109-8, § 201, 119 Stat. 23, 42 (codified at 11 U.S.C. § 502). A bankruptcy court, on the motion of the debtor, may reduce a creditor's claims by as much as 20% if the creditor unreasonably refused to negotiate an alternative payment schedule with the debtor. *Id.* The debtor must make the offer at least sixty days before filing for bankruptcy and provide payment of at least 60% of the amount owed. *Id.*

291. Other measures evincing a willingness to roll up one's sleeves and go after creditors include the Comptroller of Currency's informal pressure on banks to increase their minimum repayment rates. Mann cites some fascinating information in his new paper regarding the 2003 guidance by the Federal Financial Institutions Examination Council to recommend credit card repayment within a reasonable time and the consequent plummeting of MBNA's first quarter 2005 profit. See Mann, *supra* note 48 (suggesting sensitivity of credit card lenders' practices (and profits) to minimum repayment terms).